

IRAS e-Tax Guide

Transfer Pricing Guidelines (Fourth edition)



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Transfer Pricing Guidelines

1 Aim

- 1.1 This e-Tax guide provides taxpayers with guidance on transfer pricing relating to:
 - (a) Applying the arm's length principle when transacting with their related parties;
 - (b) Applying the arm's length principle for specific transactions, like related party services and loans;
 - (c) Maintaining transfer pricing documentation; and
 - (d) Facilities provided under tax treaties to resolve transfer pricing disputes.
- 1.2 It explains IRAS' transfer pricing compliance programme and position regarding various transfer pricing matters.
- 1.3 It consolidates the four previous e-Tax guides on transfer pricing¹. It is organised in parts, with Part I being most relevant in meeting the needs of majority of taxpayers in understanding and complying with transfer pricing requirements.
- 1.4 This e-Tax guide is relevant to you if you are a business entity incorporated or registered in Singapore or carrying on a business in Singapore and have transactions with your related parties.

2 At a glance

- 2.1 Transfer pricing concerns the prices charged in transactions between related parties.
- 2.2 Generally, a transaction between two unrelated parties will be conducted at a price approximating to the market price for the transaction. But this may not necessarily be the case when two related parties transact with each other. Nonetheless, it is important to the integrity of the tax system that the price for the transaction approximates to the market price.

¹ This e-Tax guide is a consolidation of four previous e-Tax guides on:

- (a) Transfer pricing guidelines published on 23 February 2006,
- (b) Transfer pricing consultation published on 30 July 2008,
- (c) Supplementary administrative guidance on advance pricing arrangements published on 20 October 2008, and
- (d) Transfer pricing guidelines for related party loans and related party services published on 23 February 2009.

- 2.3 To prevent price distortion, tax authorities may audit the prices of transactions between related parties to verify if they are reflective of market prices. Such audit can lead to transfer pricing adjustments bringing about double taxation.
- 2.4 Therefore, to reduce the risk of audits and double taxation, taxpayers transacting with their related parties should apply the internationally endorsed arm's length principle – that the transfer price between them should be an arm's length price as if they were unrelated parties negotiating in the market. Taxpayers should also maintain proper transfer pricing documentation to demonstrate that the pricing is arm's length.
- 2.5 If taxpayers are faced with double taxation, they may apply for a mutual agreement procedure with their tax authorities under the tax treaty provisions to eliminate double taxation. They may also apply for an advance pricing arrangement to agree in advance with one or more tax authorities the appropriate transfer pricing for their related party transactions for a period of time.

3 Glossary

3.1 Advance pricing arrangement

This is an arrangement between IRAS and the taxpayer or the relevant foreign competent authority to agree in advance an appropriate set of criteria to ascertain the transfer pricing for a taxpayer's related party transactions for a specific period of time.

3.2 Arm's length principle

The arm's length principle is the international standard to guide transfer pricing. It requires the transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party.

3.3 Arm's length range

A range of prices or margins that is acceptable for establishing that the conditions of a related party transaction are arm's length.

3.4 Comparability analysis

The process of comparing economically relevant characteristics in a related party transaction with those in independent party transactions. This involves an examination of the factors affecting the related party transaction that are non-existent in transactions between independent parties and vice-versa.

3.5 Comparable independent party transaction

A comparable independent party transaction is a transaction between two independent parties that is comparable to the related party transaction under examination. It can be either a comparable transaction between one party which is a party to the related party transaction and an independent party ("internal comparable") or between two independent parties, neither of which is a party to the related party transaction ("external comparable").

3.6 Comparable uncontrolled price ("CUP") method

A transfer pricing method that compares the price for properties or services transferred in a related party transaction to the price charged for properties or services transferred in an independent party transaction in comparable circumstances.

3.7 Competent Authority

This refers to a person or an organisation that has been appointed or delegated to perform a designated function. IRAS is the designated competent authority for matters relating to transfer pricing, which

include advance pricing arrangement and mutual agreement procedure.

3.8 **Contribution analysis**

An analysis used in the transactional profit split method under which the total profit earned by the parties from a related party transaction is divided based on the parties' relative contributions to the earning of that profit.

3.9 **Corresponding adjustment**

When a tax authority increases a taxpayer's taxable profits as a result of applying the arm's length principle to the taxpayer's transactions with its related party in another jurisdiction, double taxation arises if the same profits have been or will be included in the tax base of the related party.

To eliminate the double taxation, the tax authority in the other jurisdiction may agree to reduce the taxable profits of that related party. Such a downward adjustment to the related party's taxable profit is known as corresponding adjustment.

3.10 **Cost plus method**

A transfer pricing method where a comparable gross mark up is added to the costs incurred by the supplier of goods or services in a related party transaction to arrive at the arm's length price of that transaction.

3.11 **Direct costs**

Costs that are incurred specifically for producing a product or providing a service, such as the cost of raw materials.

3.12 **Double taxation**

Where two or more tax authorities take different positions in determining arm's length prices, double taxation may occur. Double taxation means that the same income is included in the tax base for the imposition of taxation by two or more tax authorities.

3.13 **DTA (or Avoidance of Double Taxation Agreement)**

DTA refers to agreements between governments for the avoidance of double taxation and prevention of fiscal evasion of income taxes or commonly known as tax treaties.

3.14 **FAR**

FAR refers to **F**unctions performed, **A**ssets used and **R**isks assumed.

3.15 Functional analysis

A comparison of economically significant functions performed (taking into account assets used and risks assumed) by a related party with that of an independent party.

3.16 Gross profits

The amount computed by deducting from the gross receipts of a business transaction the allocable purchases or production costs of sales, with due adjustment for increases or decreases in inventory or stock-in-trade, but without taking account of other expenses.

3.17 Independent parties (or unrelated parties)

Two parties are independent (or unrelated) parties with respect to each other if they are not related parties with respect to each other.

3.18 Independent (or unrelated) party transactions

Transactions between independent (or unrelated) parties.

3.19 Indirect costs

Costs of producing a product or service which, although closely related to the production process, may be common to several products or services (for example, the costs of a repair department that services equipment used to produce different products).

3.20 ITA

ITA refers to Income Tax Act.

3.21 Mutual agreement procedure

This is a facility through which IRAS and the relevant foreign competent authority resolve disputes regarding the application of tax treaties.

3.22 Net profit indicator (or profit level indicator)

The ratio of net profit to an appropriate base (for example, costs, sales, assets) as used in the transactional net margin method.

3.23 Related party

A related party, in relation to a person, means any other person:

- (a) Who, directly or indirectly, controls that person;
- (b) Who is, directly or indirectly, controlled by that person; or

- (c) Where both persons are, directly or indirectly, controlled by a common person.

The exact wordings of the definition are provided under Section 13(16) of the ITA.

3.24 Related party transactions

Transactions between related parties.

3.25 Resale price margin

A margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit.

3.26 Resale price method

A transfer pricing method where the resale price to the independent party is reduced by a comparable resale price margin to arrive at the arm's length price of the product transferred between the related parties.

3.27 Residual analysis

An analysis used in the transactional profit split method under which the total profit earned by the parties from a related party transaction is split in two stages: firstly, by determining the return for readily identifiable functions attributed to each party involved and secondly, by dividing the residual profit.

3.28 Self-initiated retrospective adjustments

Due to subsequent changes in circumstances, some taxpayers may review their past transfer prices relating to the transactions with their related parties. Arising from such review, they may decide to make retrospective upward or downward adjustments for past financial years to arrive at what, in the taxpayers' opinion, would be the arm's length prices. These adjustments are referred to as self-initiated retrospective adjustments.

3.29 Tested party

The use of resale price method, cost plus method or transactional net margin method requires a decision on which party to apply the transfer pricing analysis. This party is known as the tested party. Generally, the tested party is the one where a transfer pricing method can be applied in the most reliable manner and most reliable comparables can be found.

3.30 Traditional transaction methods

Transfer pricing methods that compare the prices of related party transactions with those of transactions between independent parties, namely the comparable uncontrolled price method, the resale price method, and the cost plus method.

3.31 Transactional net margin method (“TNMM”)

A transfer pricing method that compares the net profit relative to an appropriate base (for example, costs, sales, assets) that is attained by a taxpayer from a related party transaction to that of comparable independent parties.

3.32 Transactional profit methods

Transfer pricing methods that compare the profits arising from related party transactions with those generated in independent party transactions, such as the transactional net margin method and transactional profit split method.

3.33 Transactional profit split method

A transfer pricing method that is based on the concept of splitting the combined profits of a transaction between related parties in a similar way as how independent parties would under comparable circumstances.

3.34 Transfer pricing adjustment

In the event the related parties do not transact with each other at arm's length prices, tax authorities may for tax purposes, substitute the price of the transaction with one that could have been charged if the parties were unrelated. The adjustment to arrive at that price is known as a transfer pricing adjustment.

3.35 Year-end adjustments

Adjustments which taxpayers made to their actual results at the year-end closing of their accounts to arrive at what, in the taxpayers' opinion, would be the arm's length prices for their related party transactions as described in their transfer pricing analyses and policies.

PART I – TRANSFER PRICING PRINCIPLES AND FUNDAMENTALS

4 Background

4.1 Transfer pricing refers to the determination of prices charged in transactions between related parties. Such transactions can be sale or purchase of goods, provision of services, borrowing or lending of money, use or transfer of intangibles, etc.

4.2 A related party², in relation to a person³, means any other person:

- (a) Who, directly or indirectly, controls that person;
- (b) Who is, directly or indirectly, controlled by that person; or
- (c) Where both persons are, directly or indirectly, controlled by a common person.

It includes a permanent establishment through which a person carries on its business. In such a situation, the person and its permanent establishment are treated as two separate and distinct persons.

4.3 When related parties transact with each other, their pricing may not reflect market conditions due to a lack of independence in their commercial and financial relations. As a result, their profits and tax liabilities may be distorted, especially when they are located in different jurisdictions with different tax rates. This creates concerns that the related parties may not be paying their fair share of tax and are able to derive a tax advantage as a group.

4.4 To ensure taxpayers transact with their related parties at pricing that reflects independent pricing, IRAS applies the internationally endorsed arm's length principle. If taxpayers do not comply with the arm's length principle and have understated their profits, IRAS will adjust their profits upwards as provided in the Income Tax Act ("ITA")⁴.

4.5 Foreign tax authorities will likewise make upward adjustments when they find the transfer pricing of the cross-border related party transactions is not at arm's length. Such transfer pricing adjustments, by IRAS or the foreign tax authorities, may lead to double taxation.

4.6 Thus, it is important that taxpayers comply with the arm's length principle when transacting with their related parties and maintain proper transfer pricing documentation to substantiate their pricing.

² Related party is defined under Section 13(16) of the ITA.

³ Person is defined under Section 2 of the ITA to include a company, body of persons and a Hindu joint family.

⁴ This is provided under Section 34D of the ITA.

4.7 IRAS generally takes guidance from the OECD⁵ Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations⁶.

⁵ OECD stands for Organisation for Economic Co-operation and Development.

⁶ The OECD Transfer Pricing Guidelines as revised by the Actions 8-10: 2015 Final Reports on Aligning Transfer Pricing Outcomes with Value Creation.

5 The arm's length principle

Introduction

- 5.1 IRAS endorses the arm's length principle as the standard to guide transfer pricing. IRAS subscribes to the principle that profits should be taxed where the real economic activities generating the profits are performed and where value is created. A proper application of the transfer pricing rules would ensure this outcome.
- 5.2 This section covers the following:
- (a) What the arm's length principle is;
 - (b) Basis for the arm's length principle;
 - (c) Reasons for endorsing the arm's length principle;
 - (d) Guiding principles on applying the arm's length principle; and
 - (e) Three-step approach to apply the arm's length principle.

What the arm's length principle is

- 5.3 The arm's length principle requires a transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party. The premise is that where market forces drive the terms and conditions agreed in an independent party transaction, the pricing of the transaction would reflect the true economic value of the contributions made by each party in that transaction.
- 5.4 Therefore, if two related parties derive profits at levels above or below the comparable market level solely because of their special relationship, the profits will be deemed as non-arm's length. In such a case, IRAS can make necessary adjustments to the taxable profits of the Singapore taxpayer. This is to reflect the true price that would otherwise be derived on an arm's length basis.

Basis for the arm's length principle

- 5.5 Section 34D of the ITA stipulates the use of the arm's length principle for related party transactions. The concept or use of the principle is also implied or referred to in various provisions of the ITA, including Sections 32 and 53.

5.6 The arm's length principle is also found in all of Singapore's DTA, typically in:

(a) Paragraph 2 of the Business Profits Article

When attributing profits in a contracting state/ party to a permanent establishment in that state/ party, the permanent establishment should be considered as *“a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions”*.

(b) Paragraph 1 of the Associated Enterprises Article

“Where...conditions are made or imposed between...two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

Reasons for endorsing the arm's length principle

5.7 IRAS endorses the use of the arm's length principle for two main reasons:

(a) Market forces of supply and demand are the best way to allocate resources and reward effort. To avoid economic distortions that may be created by tax rules, transfer pricing for tax purposes should approximate to market pricing. Applying the arm's length principle would result in related and independent party transactions being treated equally for tax purposes. Hence, it avoids creating tax advantages or disadvantages that would distort the relative competitive positions of either party.

(b) Most tax jurisdictions adopt the arm's length principle. In doing so, taxpayers and tax authorities will have a common basis to deal with related party transactions. This should reduce the incidence of transfer pricing adjustments and improve the resolution of transfer pricing disputes. Consequently, the likelihood of double taxation will be reduced.

Guiding principles on applying the arm's length principle

5.8 IRAS recognises that the application of the arm's length principle is not without difficulties. For instance:

(a) Certain business structures and arrangements are complicated and unique, and so may rarely be encountered between

independent parties. The lack of comparable conditions established between independent parties makes it difficult to apply the arm's length principle.

- (b) Establishing the arm's length principle may require substantial analysis of large volume of data and information. Some information may not be readily available or may be of a confidential nature that cannot be disclosed without revealing business secrets.
- (c) It may also be costly for taxpayers to perform comprehensive analyses in applying the arm's length principle and prepare sufficient documentation to demonstrate compliance with the arm's length principle.

5.9 Therefore, IRAS adopts the following guiding principles on applying the arm's length principle:

- (a) Transfer pricing is not an exact science. Establishing and demonstrating compliance with the arm's length principle require the exercise of judgment. Hence, a pragmatic approach would be adopted in ascertaining arm's length pricing for related party transactions.
- (b) IRAS does not expect taxpayers to adhere rigidly to a defined set of rules in order to establish arm's length pricing. Depending on the facts and circumstances, i.e. where there is a reasonable basis for doing so, taxpayers may determine and demonstrate arm's length pricing using a different approach from those suggested in this e-Tax guide or complement those approaches suggested in this e-Tax guide.
- (c) Taxpayers would have intimate knowledge of the commercial circumstances that their businesses operate in and the economic relationships between various related parties. This puts them in a better position to perform a robust and comprehensive transfer pricing analysis to determine the arm's length price.
- (d) With the advantage of knowing their businesses and circumstances best, taxpayers should exert reasonable efforts to undertake a sound transfer pricing analysis. IRAS will consider the transfer prices determined as, prima facie, arm's length when taxpayers have:
 - Applied the arm's length principle in their analysis; and
 - Exercised reasonable efforts to comply with the arm's length principle, i.e. the transfer prices may reasonably be considered to approximate to arm's length prices.

- (e) IRAS welcomes taxpayers to discuss their concerns and difficulties in applying the arm's length principle. IRAS believes that such consultation and cooperation between taxpayers and IRAS is a mutually beneficial and pragmatic way to assist taxpayers in complying with the arm's length principle.

Three-step approach to apply the arm's length principle

5.10 IRAS recommends that taxpayers adopt the following three-step approach to apply the arm's length principle in their related party transactions:

Step 1 - Conduct comparability analysis

Step 2 - Identify the most appropriate transfer pricing method and tested party

Step 3 - Determine the arm's length results

5.11 Transfer pricing analysis always requires an element of judgment. Ultimately, the main objective in any transfer pricing analysis is to present a logical, coherent and consistent basis to demonstrate that transfer prices set between related parties are at arm's length.

5.12 The recommended three-step approach is neither mandatory nor prescriptive. A taxpayer can modify the recommended approach or adopt an alternative approach if its individual circumstances require such modifications to better arrive at the arm's length result.

Step 1 – Conduct comparability analysis

5.13 Step 1 is the process of identifying and comparing economically relevant characteristics of the transaction between related parties and those between independent parties to arrive at the characteristics that would have prevailed had the transaction been undertaken between independent parties. This should lead to a finding of:

- (a) The differences (if any) between the situations compared that can materially affect the price or margin being compared; or
- (b) Reasonably accurate adjustments that can be made to eliminate the effect of any such differences.

5.14 The comparability analysis step should examine the comparability of the transactions in three aspects:

- (a) Characteristics of goods, services or intangible properties;
- (b) Functional analysis of functions performed, assets used and risks assumed ("FAR"); and

(c) Commercial and economic circumstances.

Characteristics of goods, services or intangible properties

- 5.15 The specific characteristics of goods, services or intangible properties play a significant part in determining their values in the open market. For instance, a product with better quality and more features would, all other things being equal, fetch a higher selling price. In other words, product or service differentiation affects the price or value of the product or service.
- 5.16 The nature and features of goods, intangible properties or services transacted between related parties and those between independent parties must be examined carefully. Similarities and differences should be identified as these would influence their value.
- 5.17 Important characteristics to be examined include:

Nature of transaction	Possible comparisons
Transfer of goods	<ul style="list-style-type: none">• Physical features• Quality and reliability• Availability and volume of supply
Provision of services	Nature and extent of the services
Intangible properties	<ul style="list-style-type: none">• Form of transaction• Type and nature of the intangible property• Duration and extent of rights provided by the intangible property• Anticipated benefits from the use of the intangible property

- 5.18 If the comparable uncontrolled price (“CUP”) method is chosen as the most appropriate transfer pricing method (see Step 2 below), ensuring similarities in the actual characteristics of the product, intangible or service would be the most critical when conducting a comparability analysis.
- 5.19 On the other hand, comparisons of profit margins (as used in transfer pricing methods other than CUP) may be less sensitive to the characteristics of the product or service in question. This is because the margins generally correlate more significantly with the FAR of the taxpayer.

Functional analysis of FAR

- 5.20 In transactions between two independent parties, compensation will usually reflect the functions that each enterprise performs, taking into account assets used and risks assumed. The same principle applies to

transactions between related parties. Hence, a crucial step in comparability analysis is the comparison of economically significant FAR of the related party with that of the independent party. This is typically known as conducting a “functional analysis”.

- 5.21 Economic theory suggests that the level of return derived by a taxpayer should be directly correlated to the FAR. For instance, a taxpayer selling a product with warranty should earn a higher return compared to another taxpayer selling the same product without the warranty. The difference in margin is due to the additional function performed and risk assumed by the first taxpayer. Likewise, a product with a reputable branding is expected to fetch a higher return compared to that of a similar product without the branding. This is due to the additional asset (in this case, trademark) employed in enhancing the value of the product.
- 5.22 Identifying risks goes hand in hand with identifying functions and assets. Risks are the effect of uncertainty on the objectives of the business. The actual assumption of risks by a taxpayer to a transaction can significantly affect the pricing of that transaction at arm’s length. Thus, when analysing risks, taxpayers should observe:
- (a) The effect of the risks assumed may not be apparent in the financial statements. This does not mean that the risks do not exist but it can be that the risks have been effectively managed. Therefore, taxpayer should conduct thorough functional analysis to determine what risks have been assumed, what functions are performed that relate to or affect the assumption or impact of these risks and which party or parties to the transaction assume these risks.
 - (b) The pricing of the actual transaction should take into account the financial and other consequences of risk assumption and the remuneration for risk management.⁷ A taxpayer who assumes a risk is entitled to the upside benefits and incurs the downside costs. A taxpayer who assumes and mitigates the risk will be entitled to a greater remuneration than a taxpayer who only assumes or only mitigates the risk and does not do both.

⁷ OECD Transfer Pricing Guidelines (i.e. revisions to Section D of Chapter I in the Actions 8-10: 2015 Final Reports on Aligning Transfer Pricing Outcomes with Value Creation) provide guidance on risks and define risk management as comprises:

- (i) The capability to make decisions to take on, lay off, or decline a risk-bearing opportunity, together with the actual performance of that decision-making function,
- (ii) The capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of that decision-making function, and
- (iii) The capability to mitigate risk, that is the capability to take measures that affect risk outcomes, together with the actual performance of such risk mitigation.

- (c) To assume a risk for transfer pricing purposes, the taxpayer needs to control the risk and has the financial capacity to assume the risk.

Examples:

- If taxpayer claims that it assumes credit risk when customers default on payments, it would need to demonstrate that it has:
 - The financial capacity to assume the risk (such as availability of credit lines from banks),
 - The capability and authority to decide to take on, lay off or decline the risk (such as whether or not to sell the product to the customer or whether or not to sell on credit to customer), and
 - The capability and authority to decide whether and how to respond to the risk (such as taking legal action to recover the debt).

Taxpayer may outsource its day-to-day mitigation activities, such as credit risk analysis. However, it has to demonstrate that it has the capability to determine the objective of outsourcing the credit risk analysis, who it wants to hire to perform the credit risk analysis, etc.

- If taxpayer claims that it assumes inventory obsolescence risk, it would need to demonstrate that it has:
 - The financial capacity to assume the risk,
 - The capability and authority to decide to take on, lay off or decline the risk (such as whether or not to sell a slow moving product), and
 - The capability and authority to decide whether and how to respond to the risk (such as conducting marketing campaign to boost ailing sales or employing a diversification strategy).

The example below illustrates that arm’s length compensation should reflect the outcome of a functional analysis.

Example:

- Company A is in the business of distributing general household electrical products in the Asia Pacific (“APAC”) region. Company A purchases these products from its parent company.
- Company A conducted a thorough functional analysis which revealed:

FAR	Details
Functions	Besides distributing the products in the APAC region, Company A undertakes certain functions for

FAR	Details
	<p>the APAC region which include:</p> <ul style="list-style-type: none"> • Setting and managing all marketing strategies and campaigns • Conducting market intelligence • Analysing consumer demand and the actions of its competitors • Determining volume to be sold • Setting prices for the products to be sold • Conducting credit analysis of customers
Assets	<p>Company A owns and operates a warehouse to store the products. To ensure orders are processed quickly and to control the inventory level of slow moving products, Company A utilises a self-developed automated inventory management system to track and process inventories and shipping orders for the APAC region.</p>
Risks	<p>Company A demonstrated that it assumes credit risk and inventory obsolescence risk as in the examples in sub-paragraph (c).</p>

- The arm's length remuneration for Company A should reflect the distribution function as well as the above functions performed, assets used and risks assumed. The level of remuneration for Company A would be higher compared to another company, Company B, that merely distributes products while the above functions, assets and risks remained with Company B's parent company.

Commercial and economic circumstances

5.23 The FAR comparison should include commercial and economic circumstances. Prices may vary across different markets even for transactions involving the same property or services. In order to make meaningful comparisons of prices or margins between taxpayers or transactions, the markets and economic circumstances in which the taxpayers operate or where the transactions are undertaken should be comparable. Such comparisons include:

Circumstances	Possible comparisons
Economic circumstances	<ul style="list-style-type: none"> • Availability of substitute goods or services • Geographic location • Market size • Extent of competition in the markets • Consumer purchasing power • Level of the market at which the

Circumstances	Possible comparisons
	taxpayers operate (for example, wholesale or retail)
Government policies and regulations	<ul style="list-style-type: none"> • Price controls • National insurance
Business strategies	<ul style="list-style-type: none"> • Innovation and new product development • Degree of diversification • Risk aversion • Assessment of political changes • Duration of arrangements • Other factors bearing upon the daily conduct of business

5.24 Other relevant aspects of a comparability analysis include:

- (a) Evaluating transactions on a separate or aggregate basis;
- (b) Using multiple year data;
- (c) Considering losses; and
- (d) Selecting comparables.

Evaluating transactions on a separate or aggregate basis

5.25 Generally, the arm's length principle should be applied on a transaction-by-transaction basis to obtain the most precise approximation of arm's length conditions.

5.26 However, where individual transactions are highly inter-related and it can be demonstrated that independent parties in comparable circumstances would typically price the individual transactions on an aggregate basis, taxpayers may consider evaluating the transactions on an aggregate basis.

Using multiple year data

5.27 To enhance the reliability of the comparability analysis, taxpayers should examine multiple year data as opposed to single year data. Multiple year data helps to identify factors that may have influenced or should have influenced transfer prices, such as long term arrangements and business or product life cycles.

Considering losses

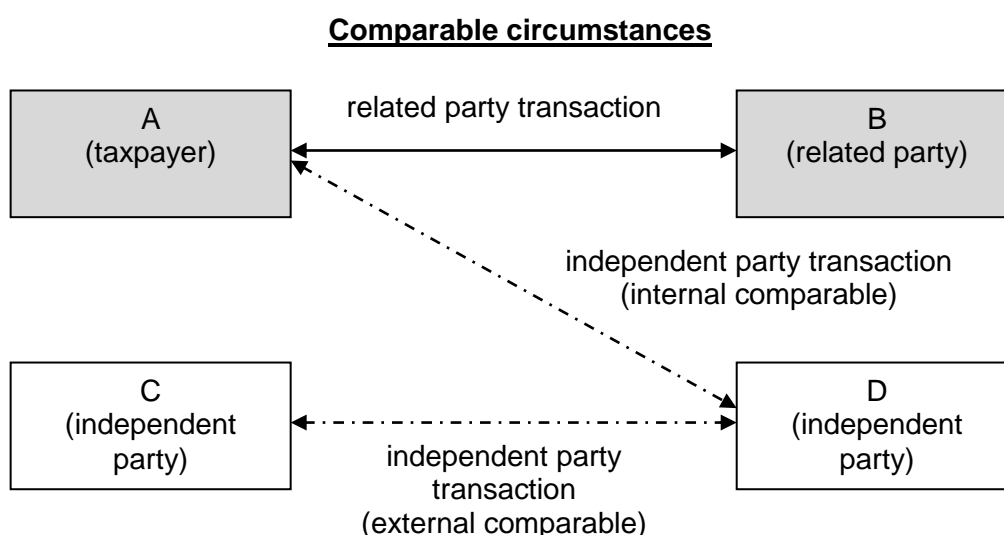
- 5.28 Generally, businesses exist with the objective to generate profits. Therefore, a taxpayer transacting with a related party at a loss indicates that the taxpayer may not be compensated at arm's length.
- 5.29 Similar to independent parties, a taxpayer transacting with a related party may sustain genuine losses for various reasons such as heavy start-up costs, unfavourable economic conditions, inefficiencies, market penetration business strategy, etc. If so, the claim should be supported with evidence that an independent party would likewise incur losses for a similar period under similar commercial and economic circumstances.

Selecting comparables

- 5.30 A sound comparability analysis requires the selection of reliable comparables. Generally, this is performed prior to or at the time of the related party transactions. These could be either internal or external comparables:

Comparables	Characteristics
Internal	Price or margin in a comparable transaction between one party which is a party to the related party transaction and an independent party.
External	Price or margin in a comparable transaction between two independent parties, neither of which is a party to the related party transaction.

The diagram below illustrates internal and external comparables:



5.31 Generally, internal comparables may have a more direct and closer relationship to the transaction under review compared to external comparables. Hence, they are preferred because the financial analysis would typically be based on similar accounting standards and information on the comparable transactions would be readily available and more reliable.

5.32 However, internal comparables may not always be more reliable than external comparables. For example, a taxpayer may sell a significant volume of products to its foreign related party and a much smaller volume to an independent party. The difference in sales volumes is likely to materially affect the comparability of the two transactions. In this case, it may be necessary to search for external comparables that are more reliable.

5.33 When selecting external comparables, taxpayers should consider the following:

(a) Commercial databases

IRAS does not have a preference for any particular commercial database as long as it provides a reliable source of information that assists taxpayers in performing comparability analysis. Whichever database the taxpayer chooses, transfer pricing documentation (refer to section 6) should be maintained to demonstrate the results of its comparability analysis.

(b) Comparables with publicly available information

Taxpayers should only use comparables with publicly available information. Such information can be readily obtained from various sources and verified, making the analyses of these comparables more reliable compared to those based on privately held information.

Between a company that is listed on a stock exchange and one that is not listed, IRAS prefers the former as a comparable because it would generally have more extensive information available in the public domain compared to the latter.

(c) Non-local comparables

As far as possible, taxpayers should use local comparables in their comparability analysis. Generally, these comparables have a higher degree of comparability in terms of their market and economic circumstances compared to non-local comparables. When taxpayers are unable to find sufficiently reliable local comparables, they may expand their search to regional comparables.

(d) Loss-generating comparables

In conducting their comparability analysis, taxpayers may come across independent parties which have sustained losses over a period of time. If other independent parties have generated profits for a similar period under similar commercial and economic circumstances, the question arises whether the transactions of the loss-making parties are truly reflective of normal business conditions. The persistently loss-making independent parties are therefore likely to be less reliable comparables. Under such circumstances, taxpayers should exclude as comparables independent parties with the following financial results:

- Weighted average loss for the tested period; or
- Loss incurred for more than half of the tested period.

Desired outcome of Step 1

5.34 The aim of the comparability analysis is a comprehensive assessment and identification of significant similarities and differences (such as product characteristics, functions performed, etc.) between the taxpayers or transactions in question and those entities or transactions to be benchmarked against.

5.35 Where reasonably accurate adjustments could be made for material differences identified, the method of making or computing such adjustments should be documented.

5.36 A thorough understanding of the level of comparability is necessary in deciding the choice of transfer pricing method and tested party (see Step 2 below).

Step 2 – Identify the most appropriate transfer pricing method and tested party

5.37 There are five internationally accepted methods for evaluating a taxpayer's transfer prices or margins against a benchmark based on the prices or margins adopted by independent parties in similar transactions.

5.38 These five methods can be categorised as follows:

Traditional transaction methods	Transactional profits methods
<ul style="list-style-type: none">• CUP method• Resale price method• Cost plus method	<ul style="list-style-type: none">• Transactional profit split method• Transactional net margin method ("TNMM")

5.39 Traditional transaction methods compare the price of related party transactions with that of transactions between independent parties. On the other hand, transactional profits methods compare the profit arising from related party transactions with that generated in independent party transactions.

CUP method

5.40 The CUP method compares the following two prices:

- (a) The price charged for properties or services transferred in a related party transaction; and
- (b) The price charged for properties or services transferred in an independent party transaction in comparable circumstances.

5.41 A difference between the two prices above may suggest that the related parties are not dealing at arm's length. Therefore, the price in the related party transaction may need to be substituted with the price in the independent party transaction.

5.42 The price or value of a property or service is very sensitive to differing characteristics, functions performed and market conditions, etc. Hence, the CUP method is reliable only if:

- (a) There is high level of comparability between the related party transaction and the independent party transaction; or
- (b) Reasonably accurate adjustments can be made to eliminate the effects of material differences.

5.43 As the CUP method is the most direct way to determine arm's length price, it should generally be preferred to the other methods. However, a less direct method is necessary if comparable independent party transactions cannot be found or where reasonably accurate adjustments for differences in comparability cannot be made.

5.44 The CUP method is most suitable to evaluate transactions involving products with very similar characteristics (in terms of type, physical features, quality and quantity transacted, etc) and undertaken in similar market or economic conditions, such as widely traded commodities. As there should not be much product differentiation for the use of the CUP method, similarities in product characteristics and market or economic conditions are much more significant considerations than the FAR of the taxpayers in determining the suitability of the CUP method.

5.45 Taxpayers should rely on internal comparables as far as possible. External comparables may be used if no reliable internal comparable transactions exist. Example 1 and Example 2 in Annex A illustrate the use of an "internal CUP" and an "external CUP" respectively.

Resale price method

- 5.46 The resale price method is applied where a product that has been purchased from a related party is resold to an independent party. Essentially, it values the functions performed by the “reseller” of a product.
- 5.47 In this method, the resale price to the independent party is reduced by a comparable gross margin (the “resale price margin”) to arrive at the arm’s length price of the product transferred between the related parties.
- 5.48 Under arm’s length conditions, the resale price margin should allow the reseller to recover its selling and operating costs, and earn a reasonable profit based on its FAR.
- 5.49 As gross profit margins represent the gross compensation (after cost of sales) for specific FAR, product differences are less critical than under the CUP method. Therefore, where the related and independent party transactions are comparable in all aspects except the product, the resale price method may be more reliable than the CUP method. Nonetheless, the more comparable the products, the more likely the resale price method will produce better results.
- 5.50 If there are material differences that affect the resale price margin earned in the related and independent party transactions, adjustments should be made to eliminate the effects of those differences.
- 5.51 The resale price method is most appropriate where the reseller adds relatively little value to the properties. The more value the reseller adds to the properties (for example, via complicated processing or assembly with other products), the harder it is to apply the resale price method. This is especially so where the reseller contributes significantly to creating or maintaining intangible properties, such as trademarks or trade names, in its activities.
- 5.52 Taxpayers should rely on internal comparables as far as possible. External comparables may be used if no reliable internal comparable transactions exist. Example 3 in Annex A illustrates the use of the resale price method.

Cost plus method

- 5.53 The cost plus method focuses on the gross mark up obtained by a supplier for property transferred or services provided to a related purchaser. Essentially, it values the functions performed by the supplier of the property or services.
- 5.54 In this method, a comparable gross mark up is added to the costs of the supplier of goods or services (“cost base”) in the related party transaction to arrive at the arm’s length price of that transaction.

5.55 Similar to the resale price method, fewer adjustments may be necessary to account for product differences compared to the CUP method. It may be appropriate to focus on other factors of comparability, such as the FAR and economic circumstances of the tested party and the comparable entities.

5.56 Applying the cost plus method requires the comparability of the gross mark up and cost base in the related and independent party transactions. If the related and independent party transactions are not comparable in all aspects and the differences have a material effect on the price or margin, adjustments should be made to eliminate the effects of those differences.

5.57 Generally, costs can be classified as follows:

Type of cost	Examples
Direct costs	<ul style="list-style-type: none"> • Cost of raw materials • Cost of labour
Indirect costs	<ul style="list-style-type: none"> • Depreciation • Repair and maintenance which may be allocated among several products
Operating expenses	<ul style="list-style-type: none"> • Marketing • General and administrative

In applying the cost plus method, direct and indirect costs of producing a good or providing a service are normally used to compute the cost base. Such costs are limited to the costs of the supplier of goods or services and should take into account an analysis of the supplier's FAR. The methods of determining the cost base should be consistent over time.

5.58 If the supplier of goods or services is the tested party and is a taxpayer in Singapore, the cost base should be determined according to the Singapore Financial Reporting Standards. Where necessary, adjustments will be made to ensure the cost base is arm's length. This means that the cost base may include cost not reflected in the tested party's accounts.

Example:

- Company A provides services to its related party, Company B.
- Company B bore certain cost of \$100,000 for the benefit of Company A and related to the services provided by A.
- Company B did not allocate the \$100,000 to Company A.
- Based on an analysis of FAR of Company A and Company B, the \$100,000 should be allocated to Company A.

- In determining the cost base for the services provided to Company B, the cost base will be adjusted to include the \$100,000 even though this amount has not been allocated to Company A and is not reflected in its accounts.
- 5.59 Where the independent party adopts a definition of cost base or a method to compute cost that is different from that of the related party, the cost base of the independent party should be adjusted accordingly to ensure comparability.
- 5.60 The cost plus method is most useful where semi-finished goods are sold between related parties or where the related party transaction involves the provision of services.
- 5.61 Taxpayers should rely on internal comparables as far as possible. External comparables may be used if no reliable internal comparable transactions exist. Example 4 in Annex A illustrates the use of the cost plus method.

Transactional profit split method

- 5.62 The transactional profit split method is based on the concept of splitting the combined profits of a transaction between related parties in a similar way as how independent parties would under comparable circumstances. It is particularly useful where:
- (a) Transactions are so highly inter-related that they cannot be evaluated separately; or
 - (b) The parties make unique and valuable contributions to the transaction; or
 - (c) The existence of unique intangible assets makes it difficult to find reliable comparables.
- 5.63 Generally, the profit to be split is the operating profit, although occasionally, it may be appropriate to carry out a split of the gross profit and then deduct the expenses incurred by or attributable to each relevant party.
- 5.64 Generally, there are two approaches to applying the transactional profit split method:
- (a) Residual analysis approach; and
 - (b) Contribution analysis approach.

5.65 Residual analysis approach: This approach splits the total profit in two stages:

(a) Stage 1: Determining the return for routine contributions

- Each party is allocated an arm's length remuneration for routine contributions. This is determined using comparable data for the readily identifiable functions (such as manufacturing, distribution, service provision, etc.) and applying one of the transfer pricing methods.
- This remuneration would generally not account for the return that would be generated by any unique and valuable contributions by the parties.

(b) Stage 2: Dividing the residual profit

- The residual profit (i.e. profit remaining after return for routine contributions in Stage 1 which is attributable to unique and valuable contributions) is then allocated between the parties based on the relative unique contributions of the parties. The contributions are identified by taking into account the FAR of each party, and valuing them as far as possible by reference to independent market data.
- The above allocation takes into consideration how independent parties would have divided such residual profit in similar circumstances.

5.66 Contribution analysis approach: Under this approach, the total profit earned by the parties from a related party transaction is divided based on the parties' relative contributions to the earning of that profit. This division can be supported by comparable data if available.

5.67 Unlike the residual analysis approach, arm's length remuneration for readily identifiable functions is not allocated to each of the parties before the transactional profit split is made.

5.68 Between the two approaches above, IRAS recommends that taxpayers use the residual analysis approach for the following reasons:

- (a) The relative value of the contribution of each party is often more difficult to quantify when one attempts to divide the total profit directly; and
- (b) The use of comparable data to allocate part of the total profit in the first stage of the residual analysis approach will generally improve the reliability of the transactional profit split method.

- 5.69 Allocation keys: The division of residual profit in the second stage of the residual analysis approach or total profit under the contribution analysis approach is generally achieved by using one or more allocation keys.
- 5.70 The choice of allocation key(s) depends on the facts and circumstances of the transaction in question. The chosen allocation key(s) should have a strong correlation with the creation of value in the related party transaction.
- 5.71 Example 5 in Annex A illustrates the use of the transactional profit split method (residual analysis approach).

TNMM

- 5.72 The TNMM compares the net profit relative to an appropriate base (such as costs, sales or assets) that is attained by a taxpayer from a related party transaction to that of comparable independent parties. This ratio of net profit and the appropriate base is commonly known as the net profit indicator or profit level indicator.
- 5.73 Like the resale price and cost plus methods, the TNMM is typically applied to only one of the parties involved in the transaction. This similarity means that the TNMM requires a level of comparability in relation to the tested party and the comparable entities that is similar to the two traditional transaction methods.
- 5.74 The main difference between the TNMM and the resale price or cost plus method is that the former focuses on the net margin instead of the gross margin of a transaction.
- 5.75 One of the weaknesses of using net margin as the basis for comparison is that it can be influenced by many factors that either do not have an effect, or have a less substantial or direct effect, on price or gross margins. Examples of such factors include the efficiency of plant and machinery used, management and personnel capabilities, competitive position, etc.
- 5.76 Unless reliable and accurate adjustments can be made to account for these differences, the TNMM may not produce reliable measures of the arm's length net margins.
- 5.77 Choice of net profit indicator or profit level indicator: This depends on the facts and circumstances of the transaction in question. Factors to consider include:
- (a) Strengths and weaknesses of the various possible indicators;
 - (b) Nature of the transaction and the appropriateness of the indicator applied to the transaction;

- (c) Availability of reliable information needed to apply the TNMM and compute the indicator; and
- (d) Degree of comparability between the related and independent party transactions, and the accuracy with which comparability adjustments can be made to eliminate differences.

5.78 Examples of net profit indicators or profit level indicators that may be used in applying the TNMM are as follows:

Net profit/ Profit level indicator	Numerator	Denominator
Operating profit margin	Operating profit	Sales
Full cost mark up	Operating profit	Total costs including all direct, indirect and operating costs
Value-added cost mark up	Operating profit	Operating costs
Return on asset	Operating profit	Operating assets

5.79 In determining the numerator and denominator, taxpayers should bear the following principles in mind:

- (a) Only those items that are directly or indirectly related to the transaction in question, and are of an operating nature should be taken into account; and
- (b) Items that are not similar to the independent party transaction being compared should be excluded.

5.80 Berry ratio: Besides the above indicators, the Berry ratio is sometimes used as an alternative financial indicator to compare the profitability attained by a taxpayer in a related party transaction to that of an independent party transaction. It is defined as the ratio of gross profit to operating expenses.

5.81 Generally, the Berry ratio is sensitive to how costs are classified, whether as operating expenses or not. Using it without caution can result in comparability issues. Therefore, it should only be used in limited cases. For example, the Berry ratio may be used when all of the following circumstances in a particular transaction are present:

- (a) The taxpayer acts as an intermediary purchasing goods from related parties and on-selling them to other related parties;

- (b) The taxpayer does not perform any value-added functions other than distribution relating to the products distributed. An example of such value-added functions is manufacturing;
- (c) The value of the functions performed by the taxpayer is not affected by the value of products distributed, e.g. accounting and billing functions;
- (d) There is a direct link between operating expenses and gross profits; and
- (e) The taxpayer does not employ any intangibles in the particular transaction.

5.82 Example 6 in Annex A illustrates the use of the TNMM.

Choice of the most appropriate transfer pricing method

5.83 Generally, the traditional transaction methods provide for a more direct comparison with independent party transactions. Hence, they would be preferred to transactional profit methods. Ultimately, the choice of the most appropriate transfer pricing method depends on the facts and circumstances of each case. Taxpayers can consider the following:

- (a) Strengths and weaknesses of the five methods above;
- (b) Nature of the transaction and appropriateness of the method applied to the transaction;
- (c) Availability of reliable information needed to apply the method; and
- (d) Degree of comparability between the related and independent party transactions, and the accuracy with which comparability adjustments can be made to eliminate differences⁸.

5.84 IRAS does not have a specific preference for any one method. Instead, the method that produces the most reliable results, taking into account the quality of available data and the degree of accuracy of adjustments, should be selected.

5.85 Taxpayers may also choose other more appropriate methods or use a combination of various methods to comply with the arm's length principle. Whichever method the taxpayer chooses, transfer pricing documentation (refer to section 6) should be maintained to demonstrate that its transfer prices are established in accordance with the arm's length principle.

⁸ As a rule of thumb, the method that requires the least adjustments will produce the most reliable measure of the arm's length price.

Choice of the tested party

- 5.86 The use of resale price method, cost plus method or TNMM requires a decision on which party to apply the transfer pricing analysis. This party is known as the tested party. Generally, the tested party is the one where:
- (a) A transfer pricing method can be applied in the most reliable manner; and
 - (b) Most reliable comparables can be found.
- 5.87 The party with the smaller scope of functions and less complex operations should be used as the tested party. This is because it would be easier to find more comparable data. The choice of such a party as the tested party would also likely result in the need for fewer comparability adjustments and hence, greater accuracy in the adjustments made.

Desired outcome of Step 2

- 5.88 At the end of Step 2, the transfer pricing method and tested party that produce the most reliable results should be identified for the arm's length analysis.

Step 3 – Determine the arm's length results

- 5.89 Once the appropriate transfer pricing method has been identified, the method is applied on the data of comparable independent party transaction(s) to arrive at the arm's length result.

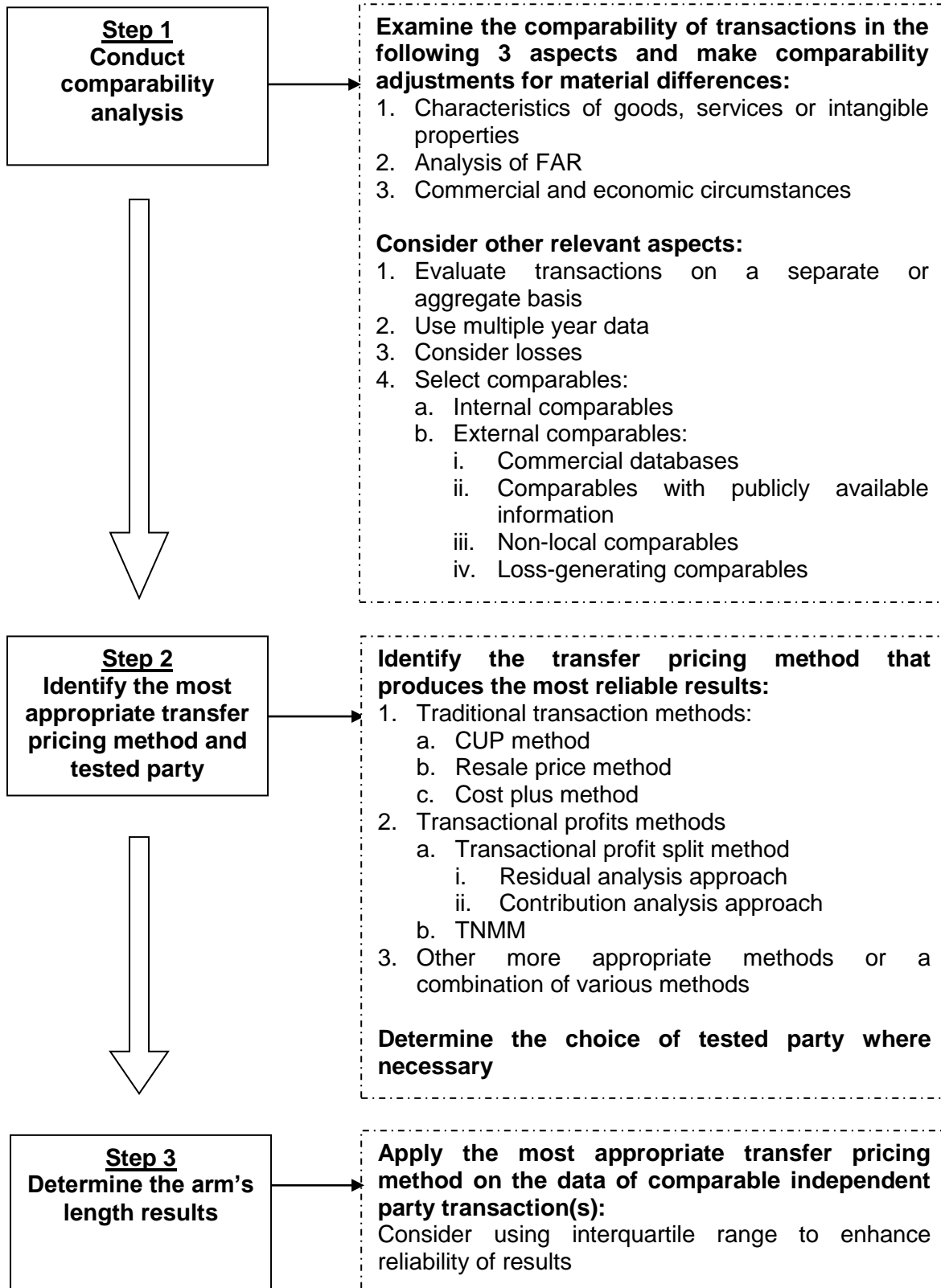
Use of an arm's length range

- 5.90 As transfer pricing is not an exact science, it is generally difficult to arrive at a specific price or margin that is the arm's length price or margin. More likely, the transfer pricing analysis would lead to a range of prices or margins.
- 5.91 A wide range of prices or margins may suggest the existence of comparability issues or defects that cannot be identified and/ or quantified in the comparability analysis and are therefore not adjusted. In such a situation, outliers such as the minimum and maximum data points should be excluded. To enhance the reliability of the comparability analysis, taxpayers could apply the interquartile range to determine the arm's length remuneration.
- 5.92 A full range (i.e. from minimum to maximum) may occasionally be considered as the arm's length price range when all the points in the range can be established to be equally reliable. An example of such a circumstance is where the taxpayer has applied the CUP method and demonstrated that all observations in the full range are equally reliable.

Desired outcome of Step 3

- 5.93 At the end of Step 3, the arm's length results would be determined. These results should then be used to guide or justify taxpayers' transfer pricing for their related party transactions.
- 5.94 Testing is the act of validating the price adopted for the related party transactions with the arm's length results obtained at the end of Step 3. Testing will enable adjustments to the price of related party transactions to be made so as to bring the price to be within the arm's length results.
- 5.95 Taxpayers should always test their related party transactions annually against the arm's length results and make appropriate year-end adjustments at year-end closing of accounts (see section 11).
- 5.96 In exceptional circumstances, IRAS may consider the testing of related party transactions over a multiple-year period on a case-by-case basis. An example of such a circumstance is where the transaction life cycle spans more than a year and so an annual testing may result in very volatile results. Taxpayers should consult IRAS before testing related party transactions over a multiple-year period.
- 5.97 The following flowchart summarises the application of the three-step approach to apply the arm's length principle:

Application of three-step approach to apply arm's length principle



6 Transfer pricing documentation

Introduction

- 6.1 This section provides guidance to facilitate taxpayers in keeping transfer pricing documentation and adopting certain practices to reduce compliance costs.
- 6.2 It is important that taxpayers prepare and keep contemporaneous records to support the pricing of their transactions with their related parties. IRAS expects taxpayers to maintain appropriate and sufficient transfer pricing documentation as provided in this section as part of the record-keeping requirements for tax⁹.

Objectives of preparing transfer pricing documentation

- 6.3 While taxpayers apply the arm's length principle when transacting with their related parties, they should also prepare records as evidence that the pricing is arm's length. Such records are known as transfer pricing documentation ("TP documentation").
- 6.4 Taxpayers should keep TP documentation to demonstrate their compliance with the arm's length principle as part of the record-keeping requirements for tax. Doing so will also avoid the consequences of being unable to deal with transfer pricing enforcement actions by tax authorities and double taxation arising from those actions.
- 6.5 By preparing TP documentation, taxpayers will achieve the following objectives:
- (a) They have conducted a thorough evaluation of their compliance with the transfer pricing rules before or at the time of filing their tax returns;
 - (b) They can readily demonstrate that their transfer prices are determined in accordance with the arm's length principle to manage domestic and cross-border transfer pricing risks;
 - (c) They are able to defend their transfer pricing in the event of a transfer pricing audit by the tax authorities;
 - (d) They help tax authorities to resolve transfer pricing issues under the Mutual Agreement Procedure ("MAP"); and
 - (e) They facilitate tax authorities in the discussion and conclusion of Advance Pricing Arrangement ("APA") Agreements.

⁹ IRAS is monitoring the compliance level and may, if necessary, consider more stringent measures including specific record-keeping regulations for transfer pricing.

What contemporaneous TP documentation means

- 6.6 Contemporaneous TP documentation refers to documentation and information that taxpayers have relied upon to determine the transfer price prior to or at the time of undertaking the transactions. Such documentation is most relevant and useful in substantiating the taxpayers' transfer pricing and preventing taxpayers from justifying their positions after the event. Hence, taxpayers should prepare and keep contemporaneous TP documentation.
- 6.7 In preparing contemporaneous TP documentation, a taxpayer may use the latest available information and data to establish its transfer pricing.

Example:

- Taxpayer's financial year end : 31 December 2015
- Latest available set of comparable data used to set prices for the financial year : Data for 2013
- Date tax return filed : 30 November 2016
- Availability of data for 2015 : 3 months after 30 November 2016

In May 2017, IRAS requests taxpayer to submit the TP documentation. The TP documentation using the 2013 comparable data is acceptable for the purpose of supporting the transfer prices for the transactions in the financial year ended 31 December 2015. This is notwithstanding that 2015 comparable data has become available in May 2017.

- 6.8 For ease of compliance, IRAS will also accept as contemporaneous TP documentation any documentation prepared at any time no later than the time of completing and filing the tax return for the financial year in which the transaction takes place. Using the same example in paragraph 6.7, for the subsequent financial year ending 31 December 2016, the taxpayer can update its existing benchmarking study and complete its TP documentation any time before the due date for the filing of the tax return in relation to that financial year (even though such documentation should ideally be done before the start of the financial year, i.e. prior to 1 January 2016).

Types of TP documentation

- 6.9 Taxpayers are to provide documentation of their group and the specific members of the group with which taxpayers transact. The TP documentation is to be organised at Group level and Entity level. If the taxpayer is the ultimate parent entity of a Singapore multinational enterprise ("MNE") group, in addition to the TP documentation described below, it may be required to file a Country-by-Country Report providing information about the global allocation of the MNE group's

revenues, profits, taxes and economic activity. The details are provided in the e-Tax guide on Country-by-Country Reporting.

Group level

6.10 At this level, the documentation should provide a good overview of the group's businesses that is relevant to the business operations in Singapore. Relevant information includes an overview of the group's global business, organisation structure, the nature of the global business operations and overall transfer pricing policies.

6.11 The following information should be included:

(a) General information on the Group as at the end of the financial year

Details (including a chart) on the worldwide organisational structure, showing the location and ownership linkages among all related parties transacting with the Singapore taxpayer.

(b) Description of Group's business relevant to the Singapore taxpayer for the financial year

General description relating to:

- The group's lines of business, products and services, geographic markets and key competitors.
- The industry dynamics, market, regulatory and economic conditions in which the group operates.
- The group's business models and strategies, including any important changes in recent years such as restructuring, acquisition or divestiture.
- Important drivers of business profit, including a list of intangibles and the related parties which legally owned them.
- The principal business activities and functions of each party in the group, including charts showing the supply chains of products and services.
- The business relationships (services provided, goods sold, development, ownership or exploitation of intangibles, financing arrangements, etc.) among related parties.

(c) Group's financial position for the financial year

- Financial statements of the group relating to the lines of business involving the Singapore taxpayer.

- A list and brief description of the group's existing unilateral advance pricing arrangements and other tax rulings relating to the allocation of income among countries.

Entity level

6.12 At this level, the documentation should provide sufficient details of the Singapore taxpayer's business and the transactions with its related parties. Detailed information includes the business operations and specific related party transactions.

6.13 The following information should be included:

(a) General information on the Singapore taxpayer as at the end of the financial year

- Description of the management structure of the Singapore taxpayer, including a description of the related parties to whom the Singapore management reports for its operations.
- Organisational chart of the Singapore taxpayer, showing the number of employees in each department.

(b) Description of the Singapore taxpayer's business for the financial year

General description or details relating to:

- The Singapore taxpayer's lines of business, products and services, geographic markets and key competitors.
- The industry dynamics, market, regulatory and economic conditions in which the Singapore taxpayer operates.
- The Singapore taxpayer's business models and strategies, including any important changes in recent years such as restructuring, acquisition or divestiture involving or affecting the Singapore taxpayer.

(c) Transactions between Singapore taxpayer and related parties subject to TP documentation for the financial year

- Details on transactions between the Singapore taxpayer and its related parties, including the identities of the related parties, the relationship, amounts and countries involved.
- Contracts or agreements showing the terms of the transactions.
- A detailed functional analysis (i.e. functions performed, assets (including intangibles) used and/ or contributed and risks

borne) of the Singapore taxpayer and relevant related parties with respect to the transactions, including any changes compared to prior years.

- A copy each of the existing unilateral and bilateral/multilateral advance pricing arrangements and other tax rulings to which IRAS is not a party and which are related to related party transactions described above.

(d) Transfer pricing analysis/ benchmarking

- The choice of the transfer pricing method and reasons to substantiate the method is the most appropriate.
- The choice of the tested party and reasons to support the choice.
- Details on comparables and the screening criteria for choosing the comparables.
- Comparability analysis of the related party transactions/ tested party and the comparables.
- Details of (and reasons for) any adjustments made to achieve comparability, including information and document needed to justify the pricing and comparability adjustments.
- The arm's length price/ margin, showing the detailed computation and explanation of any assumption made.
- Details/ reasons to support the determination and use of the range if an arm's length range is used.
- Segmented financial accounts with respect to the transactions to show the operating results of the tested party, including explanations on the assumptions (if any) used to derive the segmented information.

6.14 Paragraphs 6.10 to 6.13 set out the types of information to be documented. The list is not exhaustive. Taxpayers may include any other information which is appropriate in their circumstances.

6.15 If taxpayers have prepared similar TP documentation for purposes of complying with the requirements of other tax jurisdictions, such documentation, if relevant to the business operations in Singapore, may form part of the TP documentation for Singapore tax purposes.

Extent of TP documentation

- 6.16 Taxpayers are not expected to incur compliance costs which are disproportionate to the amount of tax revenue at risk or complexity of the transactions.
- 6.17 Taxpayers should assess the adequacy and extent of their TP documentation by evaluating the following factors based on the facts and circumstances:
- (a) Whether the transfer pricing risks in respect of their transactions or arrangements are high; and
 - (b) Whether they are able to demonstrate compliance with the arm's length principle to avoid adverse consequences.
- 6.18 To ensure the adequacy and reliability of the TP documentation, reasonable efforts should be made for the following:
- (a) Ascertain the facts and circumstances of the transactions;
 - (b) Undertake transfer pricing analysis and apply acceptable transfer price methodology to ascertain the transfer price; and
 - (c) Document and maintain relevant documents.
- 6.19 IRAS is mindful that preparing TP documentation may result in substantial compliance and administrative costs for taxpayers. Hence, IRAS is prepared to provide some administrative rules to simplify the requirements for TP documentation. Specifically, IRAS does not expect taxpayers to prepare TP documentation under the following situations¹⁰:
- (a) Where the taxpayer transacts with a related party in Singapore and such local transactions (excluding related party loans) are subject to the same Singapore tax rates for both parties;
 - (b) Where a related domestic loan (as defined in paragraph 13.3) is provided between the taxpayer and a related party in Singapore and the lender is not in the business of borrowing and lending (as explained in paragraph 13.7);
 - (c) Where the taxpayer applies the 5% cost mark-up for routine services in relation to the related party transactions concerned in accordance with the administrative practice stated in paragraph 12.26;

¹⁰ Nonetheless, the usual business records for the transactions should still be kept.

- (d) Where the taxpayer applies the indicative margin for related party loans in accordance with the administrative practice stated in paragraph 13.27;
- (e) Where the related party transactions are covered by an agreement under an APA. In such a situation, the taxpayer will keep relevant documents for the purpose of preparing the annual compliance report to demonstrate compliance with the terms of the agreement and the critical assumptions remain valid; or
- (f) Where the value or amount of the related party transactions (excluding the value or amount in sub-paragraphs (a) to (e)) disclosed in the current year's financial accounts does not exceed the thresholds shown in this Table:

Category of related party transactions	Threshold (S\$) per financial year
Purchase of goods from all related parties	15 million
Sale of goods to all related parties	15 million
Loans owed to all related parties	15 million
Loans owed by all related parties	15 million
<p>All other categories of related party transactions. Examples:</p> <ul style="list-style-type: none"> • service income, • service expense, • royalty income, • royalty expense, • rental income, • rental expense, • guarantee income, • guarantee expense. <p>For the purpose of determining if the threshold is met, aggregation should be done for each category of related party transactions¹¹. For example, all service income received from related parties is to be aggregated.</p>	1 million per category of transactions

¹¹ Strict pass-through costs should be included in the computation to determine if the threshold is met.

Example:

A Singapore company (“SingCo”) is a re-seller of electrical appliances. It also procures parts and components and assembles them into office equipment for sale. Its accounts for the current financial year show the following transactions:

Transactions	S\$ million
Total purchases of goods	165
Total sales of goods	190
Royalty payment to holding company in Country Y for branding of office equipment	0.8
Fees received from related companies for accounting services	6

Details of purchases and sales transactions are as follows:

Transactions relating to electrical appliances	S\$ million
Purchases of electrical appliances from related company in Country A (This transaction is covered by an APA agreement between the competent authorities of Country A and Singapore)	85
Purchases of electrical appliances from unrelated parties	25
Sales to a related company in Singapore subject to the same tax rate as SingCo	30
Sales to unrelated parties	90

Transactions relating to office equipment	S\$ million
Purchases of parts and components from unrelated parties	55
Sales of office equipment to a related company in Country B	70

SingCo can consider the need for TP documentation as follows:

- (i) Resale of electrical appliances

Transactions	Whether TP documentation expected?
Purchases from related company in Country A, covered by an APA agreement between Country A and Singapore	No, as the transaction is covered by an APA agreement falling within subparagraph (e). The threshold in subparagraph (f) excludes such transaction. However, SingCo should keep relevant documents for preparing

Transactions	Whether TP documentation expected?
	the annual APA compliance report. Please refer to sub-paragraph (e).
Sales to a related company in Singapore subject to the same tax rate as SingCo	No, as the transaction is a local transaction falling within sub-paragraph (a). The threshold in sub-paragraph (f) excludes such local transaction.

(ii) Office equipment business

Transactions	Whether TP documentation expected?
Sales of office equipment to a related company in Country B	Yes, as the transaction does not fall within sub-paragraphs (a) to (e) and the amount exceeds the threshold stated in sub-paragraph (f). The TP documentation prepared in accordance with paragraphs 6.10 to 6.13 will include a description of the value chain involving the purchases of parts and components, sales of assembled office equipment and payment of brand royalty.
Royalty payment to holding company in Country Y for branding of office equipment	No. Even though the transaction does not fall within sub-paragraphs (a) to (e), the amount of royalty does not exceed the threshold stated in sub-paragraph (f).

(iii) Fees received

Transactions	Whether TP documentation expected?
Fees received from related companies for accounting services	No, if SingCo applies the 5% cost mark-up for routine services in accordance with the administrative practice stated in paragraph 12.26 and therefore, falling within sub-paragraph (c). The threshold in sub-paragraph (f) excludes such transaction. However, SingCo should keep the usual business records to ascertain the service income and allowable deductions for the expenses incurred in

Transactions	Whether TP documentation expected?
	producing the service income.

6.20 Notwithstanding the administrative simplification of requirements in paragraph 6.19, taxpayers should always evaluate and decide on whether TP documentation is necessary for the purpose of complying with different TP documentation rules of other tax authorities.

6.21 If taxpayers are unable to substantiate their transfer prices are at arm's length with their TP documentation, they may suffer adverse consequences, for example:

- (a) If IRAS establishes that the taxpayers have understated their profits through improper transfer pricing, IRAS will make an upward transfer pricing adjustment under Section 34D of the ITA.
- (b) If the taxpayers suffer double taxation arising from any transfer pricing audit by IRAS or foreign tax authorities, IRAS may not support the taxpayers in MAP discussions to resolve the double taxation.
- (c) If the taxpayers apply for an APA agreement, IRAS may not accept the application.

Compliance matters relating to TP documentation

6.22 Subject to paragraph 6.19, where taxpayers are expected to prepare TP documentation, taxpayers should observe the following compliance matters:

(a) Contemporaneous TP documentation

TP documentation should be prepared on a contemporaneous basis. The date of creation or update of each document should be stated in the document.

(b) Submission of TP documentation

IRAS does not require taxpayers to submit the TP documentation when they file their tax returns. Taxpayers should keep their TP documentation and submit it to IRAS within 30 days upon request.

In the event the taxpayers are unable to provide the TP documentation upon request by IRAS, they may be penalised under Section 94(2) of the ITA for not complying with the record keeping requirements under the ITA.

(c) Review of TP documentation

Taxpayers should review their TP documentation periodically to ensure that:

- The financial analysis and economic analysis contained in the TP documentation are still accurate;
- The applied transfer pricing method disclosed in the TP documentation is still relevant; and
- The transfer pricing supported by the TP documentation is still at arm's length.

Taxpayers should update their TP documentation when there are material changes to the operating conditions that impact their functional analysis or transfer pricing analysis. In any case, IRAS encourages taxpayers to update their TP documentation at least once every three years.

(d) Period of retention of TP documentation

Taxpayers should retain the TP documentation for 5 years from the relevant year of assessment, as required in Section 67 of the ITA. However, it is prudent to retain the TP documentation for a longer period if the taxpayers are involved in an audit or a MAP.

(e) Form of TP documentation

Taxpayers can store the TP documentation in any medium, whether in paper, electronic form or any other system. However, they must be able to promptly provide the relevant information to IRAS in hardcopy or softcopy upon request.

(f) Translation of TP documentation not in English

IRAS may request for translation of any TP documentation not written in English.

PART II – TRANSFER PRICING ADMINISTRATION

7 IRAS' transfer pricing consultation programme

Introduction

7.1 This section explains the Transfer Pricing Consultation (“TPC”) programme. Through this process, IRAS reviews and audits the transfer pricing methods and documentation of selected taxpayers.

Objectives of TPC

7.2 The objectives of TPC are to ensure taxpayers comply with the transfer pricing guidelines and identify areas in which IRAS can advise taxpayers on good practices in transfer pricing.

7.3 IRAS engages the taxpayers to review:

- (a) The adequacy and timeliness of the taxpayers' TP documentation;
- (b) The appropriateness of the taxpayers' transfer pricing methods; and
- (c) The arm's length outcome of the taxpayers' transfer pricing studies.

Selection of taxpayers for TPC

7.4 IRAS selects taxpayers for TPC based on risk indicators such as:

- (a) The value of related party transactions;
- (b) The performance of the business over time; and
- (c) The likelihood that taxable profits may have been understated by inappropriate transfer pricing.

7.5 Examples of circumstances in which transfer pricing risks may be considered high are:

- (a) Transactions with cross-border related parties that are of large value relative to the other transactions of the taxpayer;
- (b) Transactions with related parties subject to a more favourable tax treatment;

- (c) Recurring losses or large swings in operating results which may be unusual given the functions and assets of the taxpayer and the risks it assumed;
- (d) Operating results that are not in line with businesses in comparable circumstances;
- (e) Use of intellectual property, proprietary knowledge or other intangibles in the business;
- (f) Transactions involving R&D or marketing activities which could lead to development or enhancement of intangibles; and
- (g) Indications (examples, through engagement with tax authorities, country's audit focus, etc.) that the transactions are likely to be subject to transfer pricing audit by tax authorities.

7.6 If necessary, IRAS may send questionnaires or information requests to obtain more data or information from taxpayers for risk assessment purposes.

Description of TPC process

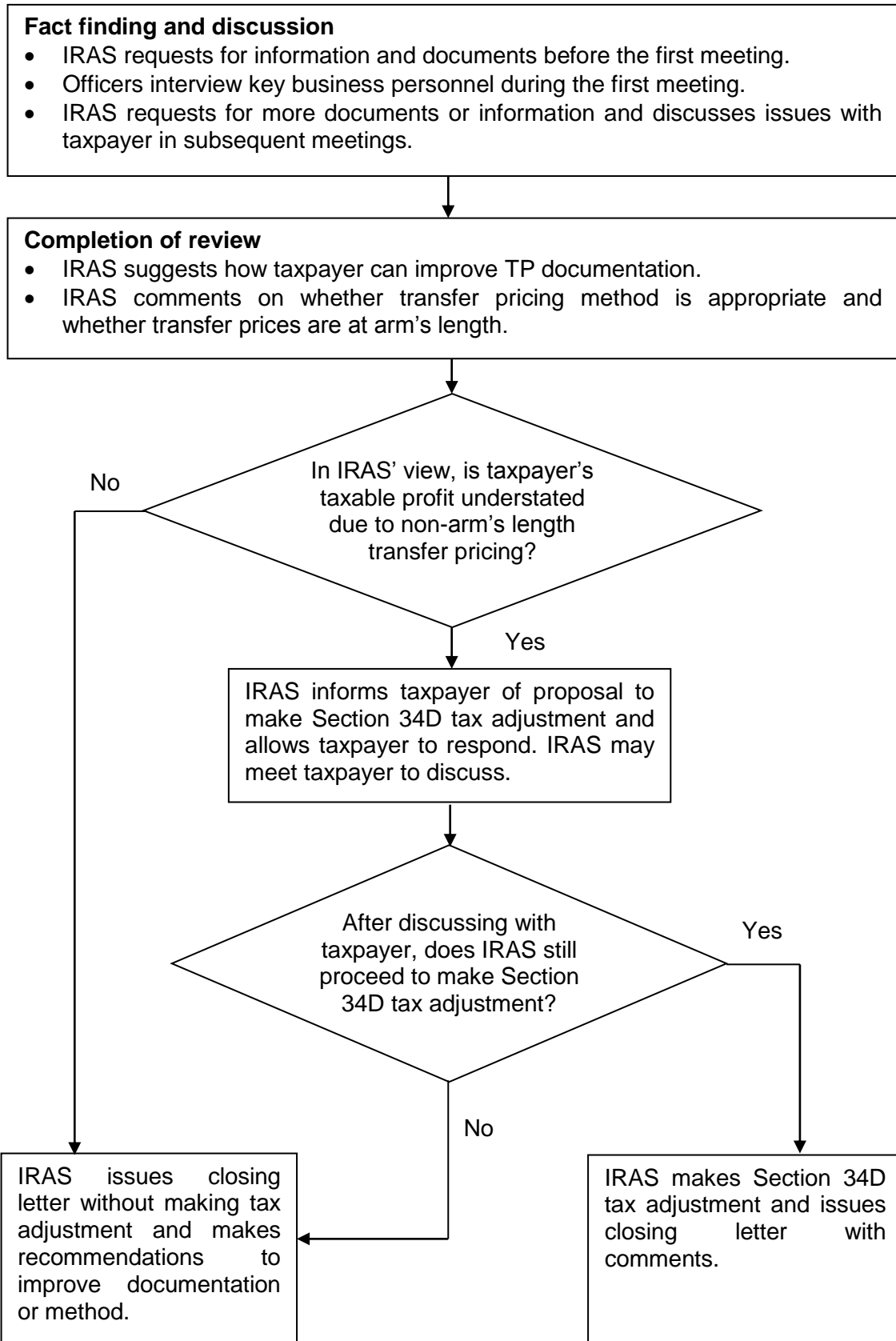
7.7 The consultation with a selected taxpayer starts with IRAS arranging for a first meeting at the taxpayer's premises, and requesting for the submission of information and documents that would be discussed at the meeting.

7.8 During the first meeting, the taxpayer's representatives present an overview of the taxpayer's business model and explain the transaction flows, the methods of pricing related party transactions and the relevant supporting documentation. IRAS will interview key personnel and review the TP documentation. IRAS will need to understand the business operations and transfer pricing, specifically:

- (a) The business model and strategies;
- (b) The conditions affecting the industry;
- (c) The transaction flows among the related parties;
- (d) The key activities each related party undertakes and the risks borne;
- (e) The assets each related party owns or uses;
- (f) The pricing of related party transactions; and
- (g) The process and documentation in place to check that the transfer prices are at arm's length.

- 7.9 After the first meeting, IRAS will request for more information or documents concerning particular issues and may arrange for subsequent meetings with the taxpayer. Based on the information gathered, IRAS will assess the adequacy of the taxpayer's TP documentation and identify transfer pricing issues for discussion with the taxpayer.
- 7.10 In some cases, IRAS may propose a tax adjustment under Section 34D of the ITA if the taxpayer's taxable profit is understated due to non-arm's length related party transactions. The taxpayer will have the opportunity to respond to IRAS' proposal and discuss how to resolve the issue, before IRAS makes the tax adjustment.
- 7.11 At the conclusion of the TPC, IRAS will send a closing letter to the taxpayer with comments on the appropriateness of the taxpayer's transfer pricing method and the adequacy of the taxpayer's TP documentation. IRAS may also make recommendations as to how the taxpayer can improve its TP documentation or its transfer pricing method.
- 7.12 The TPC process is illustrated in this flowchart:

TPC process



8 Avoiding and resolving transfer pricing disputes

Introduction

- 8.1 Where two or more tax authorities take different positions in determining arm's length prices, double taxation may occur. Double taxation means that the same income is included in the tax base for the imposition of taxation by two or more tax authorities.
- 8.2 When a Singapore tax resident taxpayer suffers double taxation from adjustments made by IRAS or a foreign tax authority to the transfer prices of its related party transactions, it can choose to resolve the issue through:
- Taking legal remedies in the jurisdiction in which the transfer pricing adjustments are made; and/ or
 - Requesting IRAS to resolve the double taxation through the Mutual Agreement Procedure ("MAP").
- 8.3 The taxpayer may also choose to avoid transfer pricing disputes by applying for an Advance Pricing Arrangement ("APA") for its related party transactions for future years.
- 8.4 This section explains MAP and APAs in greater detail and sets out the benefits, expectations and compliance rules. Sections 9 and 10 provide guidance on the processes for MAP and APAs.

At a glance – Dispute resolution through IRAS

- 8.5 The characteristics of MAP and APAs are summarised in the following table:

Characteristics	MAP	APAs	
		Bilateral/ Multilateral	Unilateral
Types <ul style="list-style-type: none"> Unilateral agreement between IRAS & taxpayer Bilateral agreement between IRAS & a foreign competent authority Multilateral agreement between IRAS & two or more foreign competent authorities 	<ul style="list-style-type: none"> ✓ ✓ 	<ul style="list-style-type: none"> ✓ ✓ 	<ul style="list-style-type: none"> ✓
Objective <ul style="list-style-type: none"> Eliminate double taxation Prevent double taxation Provide tax certainty 	<ul style="list-style-type: none"> ✓ ✓ 	<ul style="list-style-type: none"> ✓ ✓ 	<ul style="list-style-type: none"> ✓* ✓*
* Lower level of assurance			

Characteristics	MAP	APAs	
		Bilateral/ Multilateral	Unilateral
Legal basis <ul style="list-style-type: none"> • Singapore tax treaties • Domestic tax law 	✓	✓	✓
Availability <ul style="list-style-type: none"> • Singapore tax resident taxpayers • Non Singapore tax resident taxpayers 	✓	✓	✓
Financial year ("FY") <ul style="list-style-type: none"> • Past FYs • Future FYs 	✓	✓	✓
Filing fee <ul style="list-style-type: none"> • Free of charge • Fee imposed (only where Singapore does not have a tax treaty with the foreign jurisdiction) 	✓	✓	✓

What is MAP?

- 8.6 MAP is a dispute resolution facility provided under the MAP Article in Singapore's tax treaties¹². It is a facility through which IRAS and the relevant foreign competent authority resolve disputes regarding the application of tax treaties. Usually, a MAP is entered into between two competent authorities but it is possible for IRAS to enter into a multilateral MAP involving three or more competent authorities.
- 8.7 It provides an amicable way for IRAS and the relevant foreign competent authority to agree on the transfer pricing for their taxpayers' related party transactions for past FYs to eliminate double taxation arising from transfer pricing adjustments. Where the agreed MAP outcome between IRAS and the relevant foreign competent authority is accepted by the relevant taxpayers, it is binding on the relevant parties.

What is an APA?

- 8.8 An APA is a dispute prevention facility provided under the MAP Article in the Singapore's tax treaties and domestic tax law. It is an arrangement between IRAS and the taxpayer or the relevant foreign competent authority to agree in advance a set of criteria to ascertain the transfer pricing of their taxpayers' related party transactions for a specific period of time. It provides taxpayers with certainty on their transfer pricing to avoid double taxation.

¹² Details of Singapore's tax treaties and MAP relating to tax treaty matters are available at <http://www.iras.gov.sg>.

8.9 There are 3 types of APAs: unilateral, bilateral and multilateral APAs.

Unilateral APA

8.10 This is an agreement between IRAS and a taxpayer. It is suitable for the following circumstances:

- (a) Where the transfer pricing issue does not require the involvement of the foreign competent authority. For example, taxpayer seeks clarification on the domestic tax treatment in Singapore.
- (b) Where the other related party to the transaction is resident in a jurisdiction with which Singapore does not have a tax treaty.
- (c) Where the Singapore's tax treaty partner has no APA programme or has prescribed a minimum transaction threshold for an APA application of which the taxpayer's transaction falls short.

8.11 A unilateral APA offers a lower level of assurance against double taxation on the same income than a bilateral or multilateral APA. This is because the APA terms are non-binding on the foreign competent authority which is not a party to the unilateral APA process.

8.12 Taxpayers may suffer double taxation if the foreign competent authority disagrees with the agreement between IRAS and the taxpayer and makes adjustments to the transfer prices. The taxpayer will then have to rely on other remedies to resolve the double taxation. We therefore encourage taxpayers to consider preventive measures such as applying for a bilateral APA, or if this is not possible, to also secure a unilateral APA with the relevant foreign competent authority.

8.13 The Final Report on Action 5 "Countering Harmful Tax Practices More Effectively, taking into Account Transparency and Substance" published by the OECD in October 2015 sets out an agreed framework for the compulsory spontaneous exchange of information in respect of rulings. Under the framework, IRAS will spontaneously exchange information on cross-border unilateral APAs with:

- (a) jurisdictions of residence of all related parties with whom the taxpayer enters into transactions that are covered by the unilateral APAs; and
- (b) jurisdictions of residence of the taxpayer's ultimate parent entity and the immediate parent entity;

provided these jurisdictions:

- (a) have a tax treaty or exchange of information instrument with Singapore;

- (b) have the necessary legal framework and safeguards to ensure confidentiality and appropriate use of the information exchanged; and
- (c) are similarly committed to compulsory spontaneous exchange of information on cross-border unilateral APAs under the framework.

The schedule for exchange is as follows:

Unilateral APAs	Information to be exchanged
<ul style="list-style-type: none"> • Issued on or after 1 January 2012 and still in effect on 1 January 2015 • Issued on or after 1 January 2015 but before 1 April 2017 	By December 2017
<ul style="list-style-type: none"> • Issued on or after 1 April 2017 	Within three months after date of agreement

Bilateral APA

- 8.14 This is an agreement between IRAS and one of its tax treaty partners. Where the agreed APA outcome between the IRAS and foreign competent authority is accepted by the relevant taxpayers, it is binding on the relevant parties.

Multilateral APA

- 8.15 It is an agreement between IRAS and two or more of its tax treaty partners. Where the agreed APA outcome between the IRAS and foreign competent authorities is accepted by the relevant taxpayers, it is binding on all the relevant parties.

What is the period for an APA?

- 8.16 IRAS will generally accept an APA request to cover three to five future FYs (i.e. covered period). However, the duration of the covered period should be based on taxpayers' assessment that there will not be any significant changes during the covered period that may affect the validity of the APA.
- 8.17 IRAS may consider taxpayers' request to extend the APA to prior years (i.e. roll-back years) for a bilateral or multilateral APA based on the merits of the request and there is no significant difference in the facts and circumstances for the covered period and for the roll-back years. Relevant documents should be maintained to substantiate this. IRAS will not accept request to extend the APA to prior years for a unilateral APA.

- 8.18 If IRAS accepts taxpayers' request to extend the APA to the prior years for a bilateral or multilateral APA, the number of roll-back years will generally not exceed two FYs immediately prior to the covered period. Depending on the facts and circumstances of each request, IRAS may exercise its discretion to vary the number of roll-back years.
- 8.19 IRAS' acceptance of taxpayers' request for a covered period and roll-back years (in the case of a bilateral or multilateral APA) is subject to them observing the APA process in section 10. This is illustrated in the examples below:

	Company A	Company B
Period to be covered in the bilateral APA	Company intends to apply for three future FYs starting from 1 January 2017 with 2 roll-back years	Company intends to apply for three future FYs starting from 1 January 2017 with 2 roll-back years
Pre-filing meeting	Company initiated a pre-filing meeting with IRAS before 1 April 2016	Company initiated a pre-filing meeting with IRAS in August 2016

Company A followed the timeline in the APA process in section 10. The three future FYs from 1 January 2017 to 31 December 2019 will be considered the covered period. Based on the facts, circumstances and merits of the request, where IRAS accepts Company A's request for two roll-back years, the roll-back years will be the two FYs prior to the covered period, i.e. 1 January 2015 to 31 December 2016.

Company B did not follow the timeline in the APA process in section 10. As such, the FY starting 1 January 2017 will be excluded from the covered period. The covered period will therefore only be the 2 future FYs from 1 January 2018 to 31 December 2019. Based on the facts, circumstances and merits of the request, where IRAS accepts Company B's request for two roll-back years, the roll-back years will be the two FYs prior to the covered period, i.e. 1 January 2016 to 31 December 2017.

Who can apply for MAP or APA?

- 8.20 MAP, bilateral APAs and multilateral APAs are available to:
- (a) Taxpayers that are Singapore tax residents; and
 - (b) Taxpayers who are not Singapore tax residents but have a branch in Singapore. However, such applications are to be made by the taxpayers in the jurisdiction in which they are tax residents and with which Singapore has a tax treaty.

Example:

A foreign company can apply to the competent authority of the jurisdiction in which it is a tax resident for a MAP or APA for its branch operating in Singapore. The branch has to alert IRAS of the application.

In the case of an overseas branch of a Singapore tax resident company, that Singapore company can apply to IRAS for a MAP or APA concerning its overseas branch's transfer pricing affairs in a tax treaty jurisdiction.

- 8.21 Unilateral APAs are available to taxpayers regardless of whether they are Singapore tax residents.

When to apply for MAP and/ or APAs?

- 8.22 Taxpayers may seek resolution on double taxation issues that recur over multiple tax years, subject to the time limits provided in the relevant tax treaties. Taxpayers should only initiate MAP when double taxation has occurred or is almost certain. Double taxation should not be just a possibility, such as the mere occurrence of audit or examinations.

- 8.23 MAP should be initiated within the time limit specified (e.g. three years) in the MAP Article of the relevant tax treaty. Failure to do so may result in the competent authorities rejecting the MAP request.

- 8.24 Taxpayers should only apply for APA when:
- (a) There is a genuine motive to obtain certainty for the avoidance of double taxation;
 - (b) The request relates to specific current or future transactions that are not hypothetical; and
 - (c) They are certain that the cross-border related party transactions will commence or continue to take place throughout the APA covered period.

How to apply for MAP and/ or APAs?

- 8.25 If taxpayers intend to apply for MAP or APAs, they should observe the filing process provided in sections 9 and 10 for MAP and APAs respectively.

- 8.26 Taxpayers' applications for MAP or APAs are subject to acceptance by IRAS and/ or the relevant foreign competent authorities. If an application is rejected, the taxpayer may seek alternative remedies

under the relevant domestic tax law or other options to manage its transfer pricing risks.

- 8.27 If taxpayers have applied for MAP to resolve double taxation, to avoid recurrence of similar transfer pricing disputes, taxpayers may choose to concurrently apply for an APA to cover the same related party transactions for the future FYs.

What are the benefits of seeking MAP and/ or APAs?

8.28 The benefits of seeking MAP and/ or APAs include:

- (a) MAP and APAs may provide an efficient and effective way to resolve transfer pricing issues through inter-government negotiation and cooperation between taxpayers and competent authorities;
- (b) APAs provide certainty through prescribed guidance on the determination of acceptable transfer prices between related parties;
- (c) MAP relieves double taxation occurring in the audited FYs when an agreement on the appropriate transfer pricing adjustments is reached between IRAS and the relevant foreign competent authority;
- (d) Bilateral and multilateral APAs eliminate double taxation risks when taxpayers comply with the APA terms and conditions agreed between IRAS and the relevant foreign competent authorities; and
- (e) APAs avoid lengthy transfer pricing audits and penalty payments.

Understanding expectations and obligations

8.29 The acceptance of a MAP or APA application is at the discretion of the competent authorities. IRAS will consider taxpayers' request for a MAP or APA based on the merits of each case.

8.30 Upon accepting the MAP or APA application, IRAS will engage the relevant foreign competent authorities (if applicable) to conclude the MAP or APA. IRAS will apply its best efforts to bring every case to closure in a prompt, efficient and effective manner. While IRAS endeavours to achieve timely resolution of MAP or APA, the complexity of issues involved in each case will determine the actual time needed to resolve the case.

8.31 The MAP and APA negotiation is between the competent authorities and so, taxpayers do not participate in or attend as observers at the negotiations unless they are called upon to make any clarification.

8.32 The success of the MAP and APA process depends on cooperation from taxpayers. Taxpayers should therefore:

- (a) Act in good faith throughout the process;
- (b) Comply with all the requirements pertaining to pre-filing meetings and application processes;
- (c) Provide access to TP documentation (refer to section 6);
- (d) Be forthcoming in providing complete and reliable information and good quality analysis relating to the MAP and APA applications;
- (e) Adhere to all the stipulated timelines when providing any clarification, information and analysis that may be requested by IRAS and the relevant foreign competent authorities;
- (f) Update IRAS on all information that they have provided to or received from the relevant foreign competent authorities on a timely basis; and
- (g) Provide the same set of information to IRAS and the relevant foreign competent authorities.

8.33 The lack of taxpayers' cooperation may result in:

- (a) Their applications being rejected;
- (b) The MAP and APA processes being discontinued; or
- (c) No consensus being reached between IRAS and the relevant foreign competent authorities.

In such instances, taxpayers will have to rely on other remedies to eliminate double taxation under the relevant domestic tax law.

8.34 The success of the MAP and APA process also depends on the agreement between IRAS and the relevant foreign competent authorities. Taxpayers should not assume that IRAS would always be able to reach agreement for all MAP and APA cases. There may be valid constraints such as:

- (a) The lack of cooperation from taxpayers as mentioned above;
- (b) The transfer pricing adjustment cannot be varied due to domestic tax law or the adjustment has already been finalised through the domestic tax appeal process or litigation; and

- (c) The lack of suitable data to analyse the transactions for future years.

8.35 Taxpayers must understand that the MAP and APA process can be time-consuming and resource intensive. Therefore, taxpayers should evaluate their own situations and apply for MAP and/ or APAs only if:

- (a) The incidence of double taxation is certain or highly probable for the FYs to be covered by MAP and APA (see paragraphs 8.22 to 8.24);
- (b) They have a robust basis and TP documentation to justify their transfer pricing methodologies;
- (c) They have the necessary resources to support the MAP and APA process as mentioned in paragraph 8.32; and
- (d) They have evaluated the suitability of MAP and/ or APAs by conducting an in-depth cost-benefit analysis for their tax situations.

Taxpayers must also recognise that if they choose to accept a transfer pricing audit settlement with a foreign competent authority, any unprejudiced negotiation between IRAS and the foreign competent authority to eliminate double taxation arising from the audit could be challenging.

8.36 Both MAP and APAs do not deprive taxpayers of other remedies available under their respective domestic tax law. Taxpayers should inform IRAS and the relevant foreign competent authorities if the matter is adjudicated through any legal or judicial proceedings while the MAP and APA process is still on-going. The competent authorities will discuss and decide if the MAP and APA process should continue, cease or be suspended. Where the matter has been subjected to litigation and determination by the Singapore tribunals and courts, IRAS is unlikely to amend the transfer pricing adjustments that will be at odds with the determination by the Singapore tribunals and courts.

8.37 Taxpayers are not obliged to accept the outcome agreed between the competent authorities. They may withdraw the application, terminate the process or reject the agreed outcome. However, as the MAP and APA process may demand substantial investment in time and resources from the taxpayers and competent authorities, taxpayers should not terminate the process unless there are valid reasons for doing so.

Discontinuation of MAP and APAs

8.38 The lack of cooperation during any part of the MAP and APA process may result in IRAS discontinuing the MAP and/ or APA.

8.39 The table below lists some examples where IRAS may discontinue the MAP and/ or APA:

S/No.	Examples	When IRAS will discontinue the MAP or APA
1	<p><u>Non-submission of MAP or APA application</u> IRAS and the taxpayer agreed at the pre-filing meetings that the taxpayer is to submit the application by the specified date.</p> <p>If the taxpayer fails to submit the application by the specified date, IRAS will consider that the taxpayer is no longer interested in pursuing the application.</p>	<p>When IRAS does not receive any information from the taxpayer regarding its application within 6 months from the date of the last pre-filing meeting.</p>
2	<p><u>Insufficient support during MAP or APA process</u> IRAS and the taxpayer agreed on the specified timeline by which the taxpayer is to submit the information required by IRAS.</p> <p>If the taxpayer fails to provide the information by the timeline and it remains outstanding for an extended period of time, IRAS will consider that the taxpayer has withdrawn from the MAP or APA process.</p>	<p>When taxpayer fails to provide the information within 3 months after the agreed timeline.</p>
3	<p><u>Failure to provide complete information</u> The taxpayer should provide any relevant and material information that may affect the outcome of the MAP or APA to IRAS on a timely basis.</p> <p>If the taxpayer fails to provide any material information that could have affected the outcome of the MAP or APA, IRAS will consider discontinuing the MAP or APA process.</p>	<p>When it is found that the taxpayer has not provided such material information.</p>

8.40 Where a MAP or APA process has been discontinued under any of the above situations or has been withdrawn by the taxpayer, and the taxpayer subsequently wishes to resume the MAP or APA process, IRAS will consider the request as if it is a new application. IRAS will assess the merits of the request based on its prior experience.

8.41 IRAS may revoke or cancel a MAP or APA agreement, even retroactively, in the case of fraud or misrepresentation of information during a MAP or APA negotiation, or when a taxpayer fails to comply with the terms and conditions of a MAP or APA agreement.

- 8.42 Before IRAS discontinues a MAP or APA process or cancels or revokes a MAP or APA agreement, it will notify the relevant foreign competent authorities of its intention and the reasons for such action.

Other compliance matters

- 8.43 Taxpayers, who have appointed tax agents or other representatives to act on their behalf on matters relating to their MAP or APAs, are required to provide IRAS with a letter of authorisation (“LOA”). The LOA is to enable IRAS to correspond and discuss with the appointed tax agents and representatives on the matters relating to the applications. A sample of the LOA is in Annex B1.
- 8.44 IRAS does not impose any fee for MAP and/ or APAs except for unilateral APAs where the related party transactions involve a jurisdiction with which Singapore does not have a tax treaty. Such unilateral APAs will be processed under the Advance Ruling System with charges.
- 8.45 IRAS does not accept tax agents’ requests to initiate MAP or APA discussion for their clients who wish to preserve anonymity. Taxpayers should therefore engage IRAS without masking their identity if they are serious about applying for MAP or APAs.
- 8.46 All information obtained during the MAP and APA process is protected by the confidentiality provisions in the ITA and the relevant tax treaty.
- 8.47 IRAS is not precluded from conducting an audit on the taxpayer if there is non-compliance with the Singapore tax law.

9 Guidance on MAP process

Introduction

9.1 This section provides guidance on the MAP process. Please refer to section 8 for MAP details, benefits, expectations and compliance rules.

MAP process

9.2 The MAP process consists of five steps as shown in this diagram:

			Step 4	Step 5
	Step 2	Step 3	Step 4	Step 5
Step 1	1 st Pre-filing meeting	Submission of MAP application	Review & negotiation	Implementation
Notification of intent				
Taxpayer notifies IRAS of its intent within the time limit specified in the MAP Article of DTA.	IRAS meets taxpayer within 1 month upon receiving the notification of intent.	Taxpayer submits application upon IRAS indicating application can be submitted. IRAS issues acceptance letter within 1 month from receipt of the application.	IRAS informs taxpayer of the MAP outcome within 1 month from reaching agreement by the CAs.	Taxpayer and IRAS implements the MAP outcome.

Step 1 – Notification of intent

9.3 Once the MAP route is decided on, all the related parties involved should notify the competent authorities (“CAs”) of the jurisdictions in which they are tax residents of their intent to initiate the MAP. Foreign branches operating in Singapore should alert IRAS if their head offices have made such notification.

9.4 The notification to IRAS should be in writing and include a brief description of the cause and circumstances for double taxation. A guide on the minimum information required for pre-filing meeting is provided in Annex B2.

Step 2 – Pre-filing meetings

- 9.5 IRAS will meet the taxpayer within one month of receiving the MAP notification or alert. The purpose of the pre-filing meeting is for:
- (a) The taxpayer to explain the circumstances leading to the transfer pricing adjustments;
 - (b) The taxpayer to update IRAS on the actions taken by its related parties and the relevant foreign competent authorities;
 - (c) IRAS to evaluate whether the MAP request is justifiable;
 - (d) IRAS to ascertain the taxpayer's TP documentation; and
 - (e) IRAS to indicate if it is inclined to accept the MAP request.
- 9.6 If IRAS is inclined to accept the MAP request, IRAS will provide guidance on the information to be provided in the formal application as well as the next course of action.

Step 3 – Formal application

- 9.7 Unless IRAS or the other relevant foreign competent authority does not agree to the taxpayer's MAP request, the taxpayer should proceed to submit its application.
- 9.8 The application should be made in a soft copy and three hardcopies.
- 9.9 The taxpayer should also concurrently submit the MAP application to the other foreign competent authority.
- 9.10 The application should include all the details and documentation based on the guidance provided under section 6. The taxpayer should ensure that detailed descriptions on the covered transaction, covered entities, covered period and the transfer pricing methodology and analysis are also provided (refer to the sample of an APA agreement in Annex B3 for a brief description on each term). Additional information may be included if relevant.

Step 4 – Review and negotiation

- 9.11 If IRAS accepts the application, it will issue letters of acceptance to the taxpayer and the relevant foreign competent authority within one month of the receipt of the application. If IRAS rejects the application, it will notify the taxpayer and the relevant foreign competent authority in writing with reasons.
- 9.12 IRAS may seek clarification or further information from the taxpayer, hold discussions with the taxpayer or conduct site visits to the

taxpayer's premises which include interviewing the taxpayer's key personnel.

- 9.13 IRAS will regularly update the taxpayer on the progress and the outcome of the competent authorities' negotiations. In general, IRAS aims to resolve a MAP case within 24 months from receiving the taxpayer's complete application.

Step 5 – Implementation

- 9.14 When an outcome is reached between IRAS and the relevant foreign competent authority, IRAS will meet the taxpayer within one month of reaching agreement to discuss the details and implementation of the agreement. The taxpayer will have to decide whether the agreed outcome is acceptable.
- 9.15 Unless the taxpayer rejects the outcome, IRAS and the relevant foreign competent authority will proceed to:
- (a) Exchange confirmation letters and agreement to conclude the MAP;
 - (b) Give copies of the agreement to their respective taxpayers; and
 - (c) Amend the assessments by making corresponding adjustments and/ or revising the transfer pricing adjustments to relieve the double taxation. This will be done in a timely manner in accordance with domestic procedures. Please refer to paragraphs 11.19 to 11.25 for IRAS' position on corresponding adjustments.
- 9.16 If any interest or penalties have been imposed in a jurisdiction in connection with the taxation imposed that is the subject of the MAP, the MAP agreement may address whether any refund of such interest or penalties should appropriately be made.

10 Guidance on APA process

Introduction

10.1 This section provides guidance on the APA process. Please refer to section 8 for APA details, benefits, expectations and compliance rules.

APA process

10.2 The APA process consists of four steps as shown in the diagram below. Taxpayers should observe the relevant timelines as illustrated in the same diagram (i.e. timeline illustration):

X being the first day of the APA covered period
(e.g. 1 Jan 2017)

			Step 3	Step 4
	Step 1	Step 2	Step 3	Step 4
Submission of Pre-filing materials	1 st Pre-filing meeting	Submission of APA application	Review & negotiation	Implementation
Taxpayer submits pre-filing materials ≥ 10 months before X (e.g. not later than 1 Mar 2016).	Taxpayer initiates pre-filing meeting ≥ 9 months before X (e.g. not later than 1 Apr 2016).	IRAS indicates ≥ 4 months before X (e.g. not later than 1 Sep 2016) if application can be submitted. Taxpayer submits application within 3 months from receipt of IRAS' indication. IRAS issues acceptance letter within 1 month from receipt of the application.	IRAS informs taxpayer of the APA outcome within 1 month from reaching agreement by the CAs.	Taxpayer and IRAS implements the APA agreement.

10.3 The timeline is explained in the following paragraphs.

10.4 The following paragraphs will equally apply to unilateral APAs except that references to relevant foreign competent authorities ("CAs") are not relevant.

Step 1 – Pre-filing meetings

- 10.5 A taxpayer intending to file an APA application should initiate pre-filing meeting with IRAS either directly or through its tax agent. When initiating the meeting, the taxpayer or tax agent is to provide the basic information listed under items 2 to 7 of the guide on minimum information required for the pre-filing meeting in Annex B2.
- 10.6 The first pre-filing meeting should take place at least nine months before the first day of the APA covered period. (In the timeline illustration, as the first day of the APA covered period is 1 January 2017, the first pre-filing meeting should take place no later than 1 April 2016.) This is to allow sufficient time for IRAS to review the information provided and for the taxpayer to follow-up on IRAS' request for additional information prior to the submission of the application.
- 10.7 Depending on the complexity of the APA application, it may be necessary to have more than one pre-filing meeting or site visit to the taxpayer's premises. As such, the taxpayer should plan for ample lead time for these meetings and to contact IRAS early to arrange for the meetings. (In the timeline illustration, the taxpayer should strive to contact IRAS before March 2016 so that the first pre-filing meeting can take place latest by 1 April 2016.)
- 10.8 To have an effective discussion, IRAS requires:
- (a) The taxpayer to provide the information set out in the guide on minimum information required for pre-filing meeting in Annex B2 at least one month before the meeting. (In the timeline illustration, it will be no later than 1 March 2016.)
 - (b) The taxpayer's representatives who have a good and deep understanding of the business and are responsible for the taxpayer's tax matters to participate in the pre-filing meeting. The tax agent may also participate in the meeting, if the taxpayer so requests.
- 10.9 The purpose of the pre-filing meeting is for:
- (a) The taxpayer to explain its APA request and update IRAS on its meetings with the relevant foreign competent authorities;
 - (b) IRAS to ascertain the merits of the APA request before the taxpayer undertakes further work on the APA application;
 - (c) IRAS and the taxpayer to identify critical and relevant areas of focus and areas where additional information, documentation and analysis are required; and
 - (d) IRAS to ascertain the taxpayer's TP documentation.

- 10.10 IRAS will indicate if it is inclined to accept the APA request at least four months before the first day of the APA covered period. (In the timeline illustration, it will be no later than 1 September 2016.) If IRAS is inclined to accept the request, it will provide guidance on the information to be provided in the formal application as well as the next course of action.
- 10.11 It is to be highlighted that a taxpayer's initiation of pre-filing meetings or APA application does not suspend any audit or enforcement process that IRAS may be conducting on the taxpayer.

Step 2 – Formal Application

- 10.12 Unless IRAS or the other relevant foreign competent authority does not agree to the taxpayer's APA request, the taxpayer should proceed to submit its application.
- 10.13 The application should be made in a soft copy and three hardcopies.
- 10.14 The application should include all the details and documentation based on the guidance provided under section 6, including the jurisdiction of residence, name, address and tax reference number (where available) of the taxpayer's ultimate parent entity, immediate parent entity and related parties to the covered transaction. The taxpayer should ensure that detailed descriptions on the covered transaction, covered entities, covered period and the transfer pricing methodology and analysis are also provided (refer to the brief description on each term in the sample of an APA agreement in Annex B3). Additional information may be included if relevant.
- 10.15 The taxpayer should submit its application to IRAS within three months of IRAS giving its indication that the application can be submitted. Late submission may cause the APA application to be rejected. (In the timeline illustration, if IRAS indicates that it is inclined to accept the APA request on 1 September 2016, the filing deadline is no later than 30 November 2016.)
- 10.16 For bilateral and multilateral APA, the taxpayer should submit the application simultaneously to IRAS and the relevant foreign competent authorities. Where the filing deadline imposed by a foreign competent authority is earlier than IRAS', the taxpayer should observe the earlier filing deadline. This will not affect IRAS' consideration and observation of the timeline under its APA process.

Step 3 – Review and negotiation

- 10.17 If IRAS accepts the application, it will issue letters of acceptance to the taxpayer and the relevant foreign competent authority within one month of the receipt of the application. If IRAS rejects the application, it will notify the taxpayer in writing with reasons.

- 10.18 The acceptance of an APA application does not necessarily mean that IRAS endorses all the proposals in the application. IRAS reserves the right to propose alternatives either on its own or in consultation with the relevant foreign competent authority. These may include a change in transfer pricing methodology or limiting/ expanding the scope of the APA.
- 10.19 Upon accepting the application, IRAS will contact the relevant foreign competent authority to initiate APA discussion. IRAS will formulate its position concerning the APA application. IRAS may seek clarification or further information from the taxpayer (such as segmented financial data), hold discussions with the taxpayer or conduct site visits to the taxpayer's premises which include interviewing the taxpayer's key personnel.
- 10.20 IRAS will indicate the expected timeline and regularly update the taxpayer on the progress and the outcome of the competent authorities' negotiations.

Step 4 – Implementation

- 10.21 When an agreement is reached with the relevant foreign competent authority, IRAS will meet the taxpayer within one month of reaching agreement to discuss the details and implementation of the agreement. The taxpayer will have to decide whether the agreed outcome is acceptable.
- 10.22 Unless the taxpayer rejects the outcome:
- (a) IRAS will proceed to issue the APA agreement to the taxpayer in the case of a unilateral APA.
 - (b) IRAS and the relevant foreign competent authority will proceed to do the following in the case of a bilateral or multilateral APA:
 - Exchange confirmation letters and agreement to conclude the APA;
 - Give copies of the agreement to their respective taxpayers; and
 - Amend the assessments by making compensating adjustments to the roll-back years, if necessary. Please refer to paragraphs 11.11 to 11.14 for IRAS' position on compensating adjustments
- 10.23 Once an APA agreement becomes effective, the taxpayer is to comply with the APA terms stipulated in the agreement. A sample of the APA agreement is provided in Annex B3.

- 10.24 As long as the taxpayer complies with the terms and conditions of the APA agreement, IRAS will not audit the taxpayer's transfer prices for the covered period.
- 10.25 The taxpayer must file annual compliance reports to demonstrate compliance with the terms and conditions of the APA agreement together with its income tax returns. IRAS does not prescribe a fixed format for the annual compliance report. However, the taxpayer may refer to Annex B4 for a guide on annual compliance reports.
- 10.26 The taxpayer should keep relevant documents for the purpose of preparing the annual compliance reports (refer to section 6).
- 10.27 The taxpayer should notify IRAS and the relevant foreign competent authority of any breach of any of the conditions in the APA agreement as early as possible. The taxpayer should also provide an impact analysis and proposed course of action to facilitate the competent authorities' evaluation and discussion.

Renewal of an APA

- 10.28 The taxpayer may request to renew an existing APA agreement by following the same four-step APA process. The taxpayer should highlight any significant changes to the circumstances prevailing when the existing APA agreement was made.

PART III – OTHER ISSUES

11 Adjustments relating to transfer pricing

Introduction

11.1 Tax authorities have generally increased their effort in auditing the pricing of related party transactions and increased penalties for filing income tax returns reflecting inaccurate transfer pricing. Consequently, some taxpayers are initiating adjustments on their own and filing amended claims.

11.2 This section sets out IRAS' position on the various types of adjustments relating to transfer pricing.

Types of adjustments relating to transfer pricing

11.3 Broadly, taxpayers may make the following adjustments in their tax returns or after the filing of their tax returns:

- (a) Year-end adjustments at year-end closing of accounts;
- (b) Compensating adjustments;
- (c) Self-initiated retrospective adjustments; or
- (d) Corresponding adjustments arising from transfer pricing adjustments by tax authorities

At a glance – IRAS' position

11.4 IRAS' position on the 4 types of adjustments relating to transfer pricing is summarised in the following table:

Types of adjustments	Adjustments made at/ for		Situations in which adjustments are made				Tax position ¹³	
	Year-end	Prior years	Closing accounts	APA	MAP	Self-initiated	Tax	Allow
Year-end adjustments at year-end closing of accounts (paragraphs 11.5 to 11.10)	✓		✓				✓	✓
							✓	x
							Conditions met	Conditions not met

¹³ Tax position refers to the taxing of upward adjustments and/ or the allowing of downward adjustments.

Types of adjustments	Adjustments made at/ for		Situations in which adjustments are made				Tax position ¹³	
	Year-end	Prior years	Closing accounts	APA	MAP	Self-initiated	Tax	Allow
Compensating adjustments (paragraphs 11.11 to 11.14)	✓			✓			✓	✓
Corresponding adjustments (paragraphs 11.19 to 11.25)	✓	✓			✓		✓	✓
Self-initiated retrospective adjustments (paragraphs 11.15 to 11.18)		✓				✓	✓	x

Year-end adjustments at year-end closing of accounts

- 11.5 Although taxpayers have set up their group transfer pricing analyses and policies, taxpayers may find that their actual results differ from the outcomes determined in their transfer pricing study before or during their year-end closing. This can be due to difficulties in assessing market variables and making market assumptions accurately. Changes in third-party prices can also affect the actual results.
- 11.6 Therefore, taxpayers may make adjustments to their actual results at the year-end closing of their accounts to arrive at what, in the taxpayers' opinion, would be the arm's length prices for their related party transactions as described in their transfer pricing analyses and policies. These adjustments are known as year-end adjustments.
- 11.7 Upon making the adjustments, taxpayers will report the arm's length results for tax purposes even though they differ from the actual results.
- 11.8 As the purpose of the year-end adjustments is to ensure that taxpayers' tax-reported results are consistent with the arm's length prices stated in their transfer pricing analyses and policies, IRAS will accept the year-end adjustments, i.e. adjustments following the financial year end of the Singapore taxpayers when the following conditions are met:
- (a) Taxpayers must have in place transfer pricing analyses and contemporaneous TP documentation (refer to section 6) to establish the arm's length prices;

- (b) Taxpayers should make the year-end adjustments symmetrically in the accounts of the affected related parties. This is to avoid double taxation or double non taxation; and
- (c) Taxpayers must make the adjustments before filing their tax returns.

Example:

Company A is a distributor for the Group products. It buys the products from its parent company for onward distribution to third party customers in Singapore. Based on the transfer pricing analyses and TP documentation, Company A is to be rewarded with an operating margin (i.e. operating profit over sales) between 3% and 5% for its distribution function.

At the year-end closing of its accounts, Company A's actual results are as follows:

	S\$	
<u>Actual results</u>		
Sales to third party customers	25,000,000	A
Less: Purchases from parent company	<u>17,000,000</u>	
Gross profit	8,000,000	
Less: Operating expenses	<u>6,500,000</u>	
Actual operating profit	<u>1,500,000</u>	B
Actual operating margin (B / A)	6%	

As Company A's actual operating margin is higher than the arm's length operating margin of 5%, Company A makes year-end adjustments as follows:

	S\$	
<u>Arm's length results</u>		
Sales to third party customers	25,000,000	X
Less: Purchases from parent company	<u>17,250,000</u>	
Gross profit	7,750,000	
Less: Operating expenses	<u>6,500,000</u>	
Arm's length operating profit	<u>1,250,000</u>	Y
Arm's length operating margin (Y / X)	5%	

Company A reports the arm's length results for tax purposes even though they differ from the actual results. Parent company's accounts similarly reflects an increase in sales to Company A of S\$250,000 to avoid double non taxation.

On the basis that conditions (a) to (c) are fulfilled, IRAS accepts Company A's year-end adjustments.

- 11.9 By accepting the year-end adjustments, IRAS is not precluded from conducting audits and making transfer pricing adjustments

subsequently or entering into mutual agreement procedure with the relevant foreign competent authorities.

- 11.10 If the taxpayers do not meet any of the conditions in paragraph 11.8, IRAS is not precluded from bringing any upward adjustments to tax even if it does not allow the downward adjustments.

Compensating adjustments

11.11 Where taxpayers have entered into advance pricing arrangement (“APA”) with IRAS, the APA agreements (be it unilateral, bilateral or multilateral) will have stipulated the arm’s length prices.

11.12 For reasons similar to those for year-end adjustments, taxpayers may find their actual results differing from the agreed arm’s length prices provided in the APA agreements.

11.13 In such circumstances, taxpayers should make compensating adjustments in accordance with the terms in the APA agreements to arrive at the agreed arm’s length prices. Taxpayers should report such arm’s length results for tax purposes even though they differ from the actual results.

11.14 Please refer to sections 8 and 10 for the guidance on avoiding and resolving transfer pricing disputes and the APA process.

Self-initiated retrospective adjustments

11.15 Due to subsequent changes in circumstances, some taxpayers may review their past transfer prices relating to the transactions with their related parties. Arising from such review, they may decide to make retrospective upward or downward adjustments for past financial years to arrive at what, in the taxpayers’ opinion, would be the arm’s length prices. These adjustments are referred to as self-initiated retrospective adjustments.

11.16 Taxpayers may review their past transfer prices for various reasons such as:

- (a) To comply with a group global transfer pricing policy which has not been taken into account previously;
- (b) To reflect revisions in transfer pricing analyses;
- (c) To avoid potential transfer pricing adjustments by a tax authority;
or
- (d) To account for the arm’s length charge for a transaction which they have previously overlooked.

11.17 IRAS will not allow any retrospective downward adjustments in the absence of contemporaneous TP documentation (refer to section 6) supporting the adjustments.

11.18 IRAS is, however, not precluded from bringing any retrospective upward adjustments to tax if doing so would be in accordance with arm's length price.

Corresponding adjustments arising from transfer pricing adjustments by tax authorities

11.19 When a tax authority increases a taxpayer's taxable profits as a result of applying the arm's length principle to the taxpayer's transactions with its related party in another jurisdiction, double taxation arises if the same profits have been or will be included in the tax base of the related party.

11.20 To eliminate the double taxation, the tax authority in the other jurisdiction may agree to reduce the taxable profits of that related party. Such a downward adjustment to the related party's taxable profit is known as corresponding adjustment.

11.21 When taxpayers suffer double taxation arising from transfer pricing adjustments by a foreign tax authority, they should not on their own accord make any corresponding adjustment in their tax returns or tax computations without informing IRAS.

11.22 Taxpayers may seek relief from double taxation through the mutual agreement procedure ("MAP") provided in the tax treaty. Please refer to sections 8 and 9 for the guidance on avoiding and resolving transfer pricing disputes and the MAP process.

11.23 IRAS will only consider making corresponding adjustments to eliminate double taxation when:

(a) There is a tax treaty between Singapore and the foreign jurisdiction of the tax authority that made the transfer pricing adjustments; and

(b) Taxpayers have applied for the MAP provided in that tax treaty and such application is accepted by IRAS and the foreign tax authority.

11.24 IRAS will effect the corresponding adjustments to eliminate double taxation if the outcome of the MAP is accepted by IRAS, the foreign tax authority and the taxpayers.

11.25 Similarly, when taxpayers suffer double taxation arising from transfer pricing adjustments made by IRAS on their transactions with foreign related parties, taxpayers may seek to relieve the double taxation

through MAP. This is after IRAS has already considered any objection to the basis of the transfer pricing adjustment made and has affirmed the making of the adjustment. Alternatively, taxpayers may appeal to the Income Tax Board of Review.

12 Related party services

Introduction

12.1 Related party or intra-group services refer to activities that are performed by one or more members of a group of companies or businesses for related parties within the same group. Such services may include administrative, technical, financial, commercial, management, coordination and control functions.

12.2 This section covers the following:

- (a) The “benefits test” which is used to determine whether related party services have been provided;
- (b) Application of the arm’s length principle to determine the arm’s length fee for such services; and
- (c) Administrative practices for routine support services.

Using the “benefits test” to determine the provision of related party services

12.3 It is common for a parent company or a designated member within a group to undertake certain activities (e.g. administrative, financial and personnel functions) for the various related parties in the group.

12.4 To determine whether related party services have been provided, taxpayers can apply the “benefits test” to the facts and circumstances pertaining to their activities.

12.5 The “benefits test” requires consideration of the following factors:

- (a) Whether activities are performed for another party which receives, or reasonably expects to receive, benefits from such activities. If so, there is a service provided even if the expected benefits do not eventually materialise;
- (b) Whether objectively there is any commercial or practical necessity for the activities to be performed for the service recipient and an independent party would be willing to pay the service provider for the performance of those activities. If not, the benefit is too remote and there is no service provided;
- (c) Whether the benefits have economic or commercial value such that an independent party would expect to pay to receive the benefits or be paid for providing the benefits. If not, there is no service provided; and

- (d) Whether the benefits are identifiable and capable of being valued. In other words, the benefits must be sufficiently direct and substantial. Otherwise, there is no service provided.

Application of the arm's length principle to determine arm's length fee

12.6 After establishing that a related party service has been provided, taxpayers should determine the appropriate charge for the service provided based on the arm's length principle. This requires a related party transaction to be viewed as having been made under comparable circumstances as a transaction with an independent party.

12.7 To do so, taxpayers can adopt the three-step approach found in section 5. In addition, they may consider the following:

Comparability analysis for related party services

12.8 When performing the comparability analysis for related party services, taxpayers should analyse:

- (a) From the perspectives of the service provider

The price it would charge an independent party, taking into account its costs; and

- (b) From the perspectives of the recipient

The price it is willing to pay for the services, considering what it would have otherwise paid to independent parties for similar services under similar circumstances.

Choice of most appropriate transfer pricing method

12.9 When deciding on the most appropriate transfer pricing method, taxpayers should remain guided by the considerations in paragraph 5.83.

12.10 The following methods are often the most appropriate choices to determine the arm's length fee for related party services:

- (a) CUP method; or
- (b) Cost plus method; or
- (c) TNMM.

Determination of cost base

12.11 If a cost based transfer pricing method (CUP or cost plus methods) or profit level indicator (under the TNMM) has been selected to determine

the arm's length fee, the next step is to establish the relevant cost base. To do so, taxpayers should consider:

- (a) Whether a direct or indirect charge method is appropriate; and
- (b) Whether the costs are strict pass-through costs.

Direct or indirect charge method

12.12 The direct charge method is applicable for services (e.g. conduct of market survey for a particular new product developed by a related party) where the following are clearly identifiable:

- (a) Actual work done;
- (b) Beneficiary of the services;
- (c) Basis of charge; and
- (d) Costs expended in providing the services.

12.13 This method facilitates review and examination by tax authorities. Therefore, wherever possible, taxpayers should adopt this method in determining the appropriate charges for related party services.

12.14 However, it may not be practical for taxpayers to adopt the direct charge method for all related party services. For instance, a taxpayer may provide accounting services for all members belonging to the same group. It may not be possible for the taxpayer to identify the benefits received by, or the service performed specifically for, individual members.

12.15 In such a case, the taxpayer may have to use an indirect charge method to approximate the charges. Such a method entails the use of an appropriate apportionment basis or allocation key to charge for the service provided. Examples of possible allocation keys include gross sales, income or receipts, loans and deposits, headcount, floor area and asset size.

12.16 The main consideration when using an indirect charge method is the appropriateness of the apportionment basis or allocation key. This would depend on the nature and usage of the service.

12.17 Generally, the most appropriate allocation key is one that most accurately reflects the share of benefits received or is expected to be received by the service recipients. This is largely a question of judgment.

12.18 Taxpayers should demonstrate that due consideration and analysis have been undertaken in arriving at the choice of allocation key. The

allocation key adopted by the taxpayer would be acceptable as long as it is:

- (a) Reasonable;
- (b) Founded on sound accounting principles; and
- (c) Consistently applied year to year throughout the group unless there are very good reasons for not doing so.

Strict pass-through costs

12.19 Sometimes, a group service provider may arrange and pay for, on behalf of its related parties, services acquired from other service providers (whether independent or related). The group service provider may pass on the costs of the acquired services to its related parties without a mark-up, provided that:

- (a) The acquired services are for the benefit of the related parties;
- (b) The acquired services have been charged at arm's length;
- (c) The group service provider is merely the paying agent and does not enhance the value of the acquired services; and
- (d) The costs of the acquired services are the legal or contractual liabilities of the related parties. This condition can be met even if the group service provider is legally or contractually liable to pay for the acquired services. This is provided that it has a written agreement with its related parties for the latter to assume the liabilities relating to the acquired services.

12.20 The above treatment is premised on the view that independent parties in comparable situations would agree not to earn a mark-up on the costs incurred.

12.21 The group service provider should nonetheless charge an appropriate arm's length mark-up for its function in arranging and paying for the acquired services on behalf of its related parties. The mark-up should:

- (a) Be based on the aggregate costs of its resources in performing the said function; and
- (b) Reflect the nature of its own services and extent of value-add generated for the related parties in the group benefiting from such services.

12.22 For example, a group service provider may use its own resources to arrange, select and liaise for the provision of corporate secretariat services by an independent firm. The charges by the independent firm may qualify as strict pass-through costs. However, the group service

provider's own costs should be charged to its related parties using an appropriate arm's length mark-up.

Administrative practices for routine support services

Routine support services

12.23 It is common for parent companies or group service companies to provide certain routine services to related parties. These services are usually:

- (a) Related to activities that support the group's main business;
- (b) Different from the main activities by which the group derives its income;
- (c) Not intended to be carried out for profit but may be required for the effective functioning of the group; and
- (d) Centralised within the parent or group service company for business convenience and efficiency reasons.

12.24 Annex C shows a list of routine support services that are commonly provided on an intra-group basis across many industries.

12.25 Strictly, taxpayers should perform a proper transfer pricing analysis to determine the arm's length remuneration for performing such routine support services. However, doing so for every type of service would greatly increase administrative and compliance burdens for the taxpayers. It would also increase IRAS' administrative costs to evaluate them.

5% cost mark-up for certain routine support services

12.26 Typically, routine support services do not have a significant arm's length mark-up. Therefore, as an administrative practice, taxpayers can apply a 5% cost mark-up for certain routine support services as a reasonable arm's length charge when certain conditions are satisfied. This will facilitate their compliance with the arm's length principle and yet maintain a high level of adherence to the arm's length principle. The conditions are:

- (a) The routine support services fall within Annex C¹⁴;

¹⁴ Annex C may be modified or expanded on upon subsequent review. Taxpayers are welcome to provide their feedback to IRAS on related party services that are in the nature of routine support services but have not been included in Annex C.

Nonetheless, a taxpayer may be of the view that the group services it provides constitute routine support services based on its own facts and circumstances. Even though the services are not specifically listed in Annex C, the taxpayer may request for a confirmation from IRAS.

- (b) The service provider does not offer the same routine support services to an unrelated party; and
- (c) All costs including direct, indirect and operating costs (see paragraph 5.57) relating to the routine support services performed are taken into account in computing the 5% mark-up.

12.27 The 5% cost mark-up for routine support services gives taxpayers an alternative to performing detailed transfer pricing analysis. Service providers may nonetheless adopt a mark-up that is different from 5%. In doing so, taxpayers should:

- (a) Support their basis with detailed transfer pricing analysis;
- (b) Apply the mark-up consistently year-after-year throughout the group until there are material changes to the circumstances or services provided; and
- (c) Review the mark-up regularly to ensure that it continues to reflect arm's length conditions in their situations.

Routine support services provided on a cost-pooling basis

12.28 This section deals with the intra-group sharing or "pooling" of costs under a cost-pooling contract among members. It does not address Cost Contribution Arrangements or CCAs as referred to in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Chapter VIII). Unlike cost-pooling contracts, CCAs are often entered into specifically to develop intangible assets.

12.29 Members of a corporate group may occasionally enter into a cost-pooling contract among themselves to share the costs of routine support services. This arises from a common need for such services. It also results in mutual benefit, a concept that is fundamental to cost-pooling.

12.30 A party to the cost-pooling contract must:

- (a) Reasonably expect to benefit or actually benefits from the services in respect of which costs are being shared; and
- (b) Contribute at arm's length to the costs of providing the service. The contribution is in proportion to the nature and extent of expected benefits that it receives. No payment other than the costs allocated to each participant should be made.

No mark-up for payments charged under a cost-pooling arrangement

12.31 As an administrative practice, payments may be charged without mark-up to a related party for its proportionate share of the cost of services in a cost-pooling arrangement on the conditions that:

- (a) Each participant's share of the costs must be borne in the form of cash or other monetary contributions¹⁵;
- (b) The services are not provided to any unrelated party;
- (c) The provision of services to the related parties is not the service provider's principal activity. This will depend on the specific facts and circumstances of each case. If the costs of providing the services do not exceed 15%¹⁶ of the service provider's total expenses as reflected in its accounts for the financial year concerned, the services are presumed not to be the principal activity of the service provider for that year;
- (d) The services being provided are listed in Annex C; and
- (e) There is sufficient documentation showing that the parties intended to enter into a cost-pooling arrangement before the provision of the services. For example, a cost-pooling arrangement should be supported by a written agreement which, among other things, is duly signed by all related parties involved in the arrangement.

12.32 Taxpayers should maintain TP documentation (refer to section 6) to support the arm's length basis of the allocation of costs under a cost-pooling arrangement. To minimise the risk of double taxation, such documentation should include:

- (a) Description of the types of services provided;
- (b) Reasons for selecting a specific method of allocating costs;
- (c) Contributions by each related party;
- (d) Benefits that are anticipated; and
- (e) Details of the calculations used.

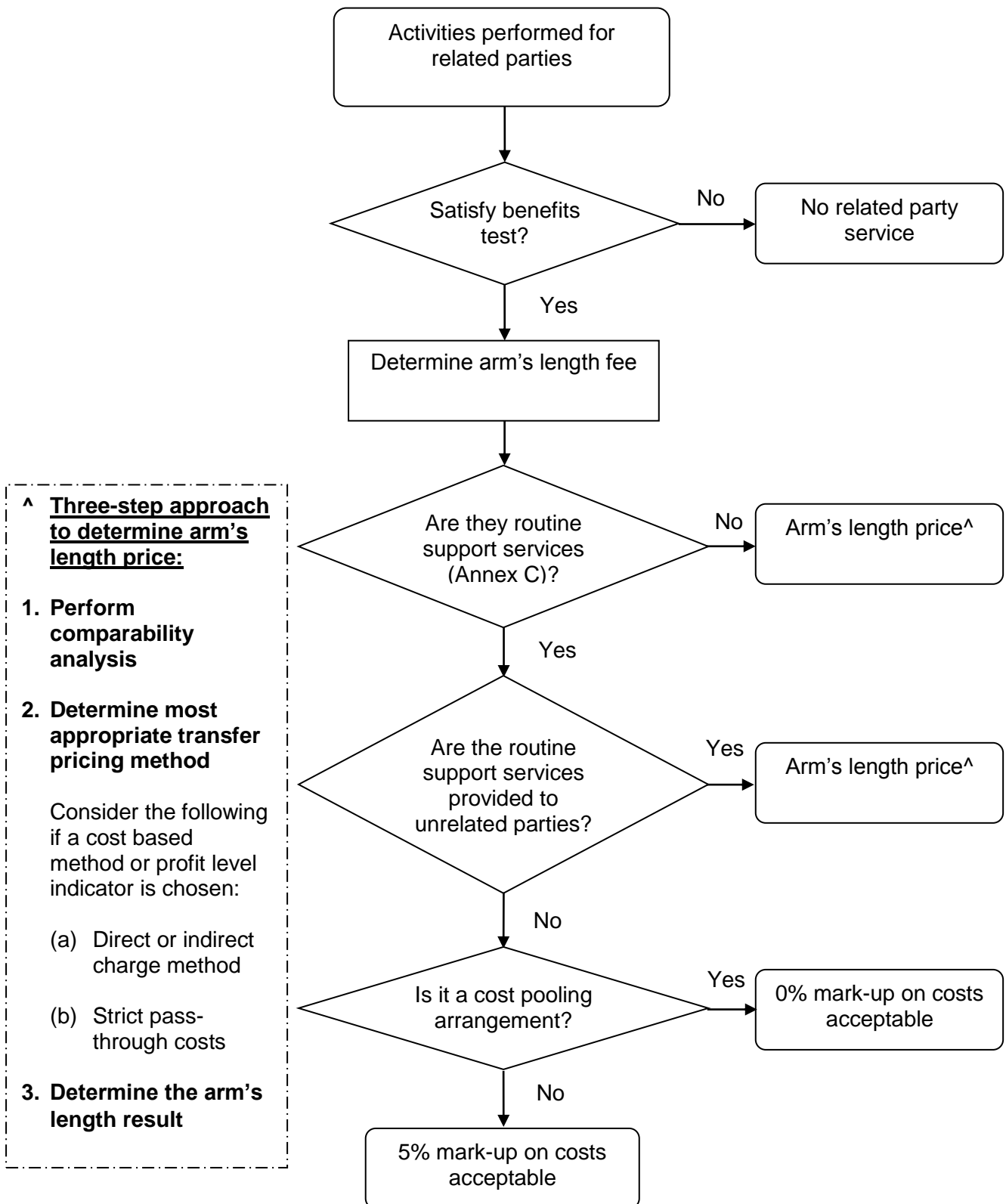
Summary on related party services

12.33 The following flowchart summarises the application of the arm's length principle to related party services:

¹⁵ IRAS will monitor the developments in commercial practices and assess if there is a need to include other forms of contributions.

¹⁶ In computing the 15% threshold, the numerator should comprise all costs associated with the services provided under various cost pooling arrangements by the service provider. The denominator should include all expenses of the service provider, including expenses that have been netted off in the financial accounts against reimbursements received from related parties under the cost-pooling arrangements. It should however exclude strict pass-through costs.

Application of the arm's length principle to related party services



13 Related party loans

Introduction

13.1 When taxpayers lend money to or borrow money from their related parties, they should adhere to the arm's length principle when determining the return to be charged for the use of money.

13.2 This section provides guidance on:

- (a) The application of the arm's length principle to related party loans; and
- (b) The determination of the arm's length interest.

Application of the arm's length principle to related party loans

13.3 A related party loan arises when a taxpayer lends money to or borrows money from a related party. It can be:

Type of loan	Parties to the loan
Related domestic loan	Where a taxpayer in Singapore lends to or borrows from a related party in Singapore
Related cross-border loan	Where a taxpayer in Singapore lends to or borrows from a foreign related party

13.4 A loan can be in any form regardless of whether or not it is made through a written agreement. It includes:

- (a) Credit facilities; or
- (b) Intercompany credit balances arising from the normal course of sales and provision of services which are left uncollected over a substantial period of time that is beyond what a third party trade creditor would typically allow.

13.5 When a taxpayer makes a loan to or becomes a creditor of a related party, it should apply the arm's length principle and charge the related party for the use of the funds at an arm's length interest rate. Similarly, a taxpayer should apply the arm's length principle when it receives a loan from or becomes a debtor of a related party.

13.6 The arm's length interest rate is the interest rate which would have been charged between independent parties under similar circumstances at the time the indebtedness arose.

13.7 The application of the arm's length principle to related party loans is as follows:

Type of loans	Status of taxpayer which is a lender	Application of arm's length principle
Related domestic loans	Where taxpayer is not in the business of borrowing and lending	To restrict interest deduction as a proxy to the arm's length principle (see paragraphs 13.8 and 13.9)
	Where taxpayer is in the business of borrowing and lending (e.g. banks or other financial institutions, finance and treasury centres)	To determine the interest rate based on arm's length principle (see paragraph 13.10)
Related cross-border loans	Whether or not taxpayer is in the business of borrowing and lending	To determine the interest rate based on arm's length principle (see paragraph 13.10)

13.8 In the case of a related domestic loan provided by a taxpayer which is not in the business of borrowing and lending, IRAS will apply interest restriction in place of the arm's length methodology. This is done by limiting the taxpayer's claim for any interest expense to the interest charged on such loan.

Example:

- Taxpayer A provided a loan to Taxpayer B S\$100,000
- Interest charged by Taxpayer A in 2014 S\$100
- Interest expense incurred by Taxpayer A
in providing the loan in 2014 S\$1,000
- Taxpayer A's interest expense claim of S\$1,000 is limited to S\$100

13.9 While the interest restriction does not exactly conform to the arm's length principle, it nonetheless serves as a close proxy. This is to facilitate taxpayers' efforts in complying with the arm's length principle for related party loans while keeping compliance cost low.

13.10 In all other cases, taxpayers should adhere to the arm's length methodology to determine the interest charges. In the event that taxpayers fail to do so:

- (a) IRAS will disregard any interest expense in excess of the arm's length amount determined by IRAS for tax deduction purpose. This is notwithstanding that tax may have been withheld on the full interest payment to the foreign related party.
- (b) IRAS may not support the taxpayers in MAP discussions to resolve any double taxation arising from any transfer pricing adjustments made by IRAS or foreign tax authorities in relation to the interest charges.

Determination of the arm's length interest

13.11 Section 5 provides a framework to guide taxpayers in the application of the arm's length principle. Taxpayers can apply this framework when analysing and determining the arm's length interest charges for related party loans.

13.12 The following paragraphs provide guidance on the application of the three-step approach in paragraph 5.10 to determine the arm's length interest charges for related party loans.

Step 1 – Conduct a comparability analysis

13.13 Taxpayers need to consider all the relevant facts and circumstances relating to the loan, including the following comparability factors:

- (a) Nature and purpose of the loan;
- (b) Market conditions at the time the loan is granted;
- (c) Principal amount, duration and terms of the loan;
- (d) Currency in which the loan is denominated;
- (e) Exchange risks borne by the lender or borrower;
- (f) Security offered by the borrower;
- (g) Guarantees involved in the loan;
- (h) Ranking of the loan (senior or subordinated); and
- (i) Credit standing of the borrower.

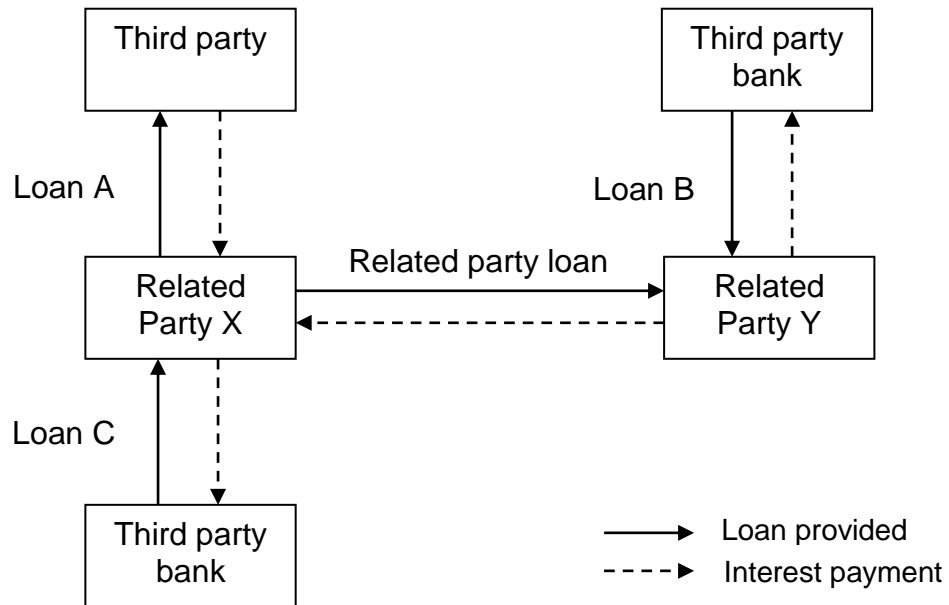
Step 2 – Identify the most appropriate transfer pricing method

13.14 The CUP method is the preferred method for determining the arm's length pricing for related party loans as it is the most suitable method for loan transactions.

13.15 If circumstances render another method, other than CUP method, to be more appropriate, taxpayers can apply that method. Taxpayers are to maintain documentation to justify why that method is more suitable.

13.16 The selection of internal CUP is illustrated with an example as follow:

- (a) In this illustration, X provides a loan to Y. It is assumed that all the loans are comparable based on a comparability analysis.



- (b) If X is a taxpayer in Singapore and is not in the business of borrowing and lending and Y is a foreign related party, the internal CUP that X can use to determine the arm's length interest rate for the loan to Y is:

- Loan A is the preferred internal CUP as X should charge Y the same interest rate that it charges a third party.
- Loan B, if Loan A is not available, is the next internal CUP that X can use as X should charge Y the same interest rate that a third party charges Y.
- Loan C if both Loan A and Loan B are not available and the moneys borrowed by X are on-lent to Y, i.e. X should charge Y the same interest rate that a third party charges X.

- (c) If Y is a taxpayer in Singapore and X is a foreign related party, the internal CUP that Y can use to determine the arm's length interest rate for the loan from X is:

- Loan B is the preferred internal CUP as Y should pay X interest at the same interest rate that it pays a third party.

- Loan A, if Loan B is not available, is the next internal CUP that Y can use as Y should pay X interest at the same interest rate that X charges a third party.
- Loan C if both Loan A and Loan B are not available and the moneys borrowed by X are on-lent to Y, i.e. Y should pay X interest at the same interest rate that a third party charges X.

Step 3 – Determine the arm’s length results

- 13.17 The arm’s length interest rate is usually made up of a base reference rate and a credit spread or margin.
- 13.18 The base reference rate is usually a publicly available rate such as the Singapore Inter Bank Offered Rate (“SIBOR”), the London Inter Bank Offered Rate (“LIBOR”) or prime rates offered by banks.
- 13.19 The margin is mainly to compensate the lender for bearing the credit risk of the borrower defaulting on the loan.
- 13.20 If CUPs are available to determine the interest rate but they are not entirely comparable to the tested related party loan, comparability adjustments can be made to eliminate the differences. Broadly, the two main categories of comparability adjustments to apply to the interest rate on the loans are:
- (a) Those applicable to the base reference rate; and
 - (b) Those applicable to the margin.
- 13.21 The comparability adjustment applicable to the base reference rate may involve selecting, and substituting, the most appropriate base reference rate based on the currency and tenor of the loan.

Example:

- The tested borrower’s related party loan is denominated in S\$ within the Singapore financial and debt market.
 - The internal CUP has a base reference rate of US LIBOR.
 - Assumed all other factors are comparable.
 - The comparability adjustment to the internal CUP will be to substitute the US LIBOR with S\$ SIBOR to adjust for the differences in currency.
- 13.22 The comparability adjustment applicable to the margin may involve adjusting the difference in the credit risk profile of the tested borrower and the comparable borrower. For example, comparability adjustment may be made for the differences in credit risk profile between the tested borrower and the comparable borrower. This may be done using credit estimation models.

13.23 If an appropriate CUP is not available, taxpayers can apply the following steps to determine the arm's length interest rate:

(a) Identify a suitable base reference rate.

(b) Estimate credit rating of borrower

As the margin compensates the lender for bearing the credit risk of the borrower defaulting on the loan, it can be determined by reference to the credit rating of the borrower. The credit rating of the borrower can be estimated using commercial credit scoring software provided by credit rating agencies based on information available at the time the related party loans are obtained.

(c) Determine the arm's length interest rate

The arm's length interest rate is determined by adding the margin derived from the estimated credit rating in sub-paragraph (b) above to the base reference rate in sub-paragraph (a).

13.24 IRAS prefers evaluating the credit rating of the borrower on a standalone basis. However, IRAS may accept a credit rating of the borrower based on the overall group credit rating if it can be substantiated that an independent lender will similarly accept such group credit rating.

13.25 As every related party loan can be different, taxpayers are to determine the arm's length interest rate for each loan individually. However, to reduce the compliance burden for taxpayers with multiple related party loans, taxpayers can choose to determine the arm's length interest rate for comparable loans on an aggregate basis using the comparability factors listed in paragraph 13.13 as a guide.

13.26 Taxpayers are to maintain TP documentation relating to their basis of determining the interest rates for the related party loans.

Administrative practice for indicative margins on related party loans

13.27 To facilitate compliance with the arm's length principle and maintain a high level of adherence to the arm's length principle, IRAS has put in place an indicative margin which taxpayers can apply on their related party loans obtained or provided from 1 January 2017.

13.28 The indicative margin is published on IRAS' website and will be updated at the beginning of each year.

13.29 The indicative margin is not mandatory. It gives taxpayers an alternative to performing detailed transfer pricing analysis on their related party loans. Taxpayers may adopt a margin that is different from the indicative margin. This should be supported based on the

guidance provided in this section to determine the arm's length interest rates.

Application of the indicative margin

13.30 Taxpayers can choose to apply the indicative margin to each related party loan that does not exceed S\$15 million at the time the loan is obtained or provided. The threshold is based on the loan committed and not the loan utilised. For example, taxpayer obtained a loan facility of S\$20 million from a related party. Taxpayer cannot apply the indicative margin notwithstanding that the amount utilised or intended to be utilised is less than S\$15 million.

13.31 The indicative margin is applicable to both Singapore-dollar denominated and foreign currency denominated related party loans. For related party loans denominated in foreign currencies, the threshold (in Singapore dollars) is to be determined based on the prevailing exchange rate at the time the loans are obtained or provided.

Example:

- Taxpayer provided a loan (i.e. Loan A) to a related party
- Loan committed under Loan A is US\$14 million
- Suppose the exchange rate at the time Loan A is provided is US\$1: S\$1.42
- S\$ equivalent of Loan A is S\$19.88 million
- Taxpayer cannot apply the indicative margin for Loan A as it exceeds the threshold of S\$15 million

13.32 Taxpayers would decide the appropriate base reference rate on which to apply the indicative margin.

Example:

- Taxpayer provided a floating rate loan of S\$10 million to its related party on 1 January 2017
- Taxpayer used SIBOR as the base reference rate for the related party loan
- Taxpayer chose to apply the indicative margin
- Suppose the indicative margin is 2.50%
- The interest rate for the related party loan would be 2.50% plus the appropriate SIBOR rate

13.33 For fixed rate related party loans, taxpayers can apply an appropriate swap rate as the base reference rate. For fixed rate related party loans denominated in Singapore dollars, besides an appropriate Singapore-dollar swap rate, taxpayers can consider applying an appropriate Singapore Government Securities ("SGS") yield¹⁷ as the base reference rate.

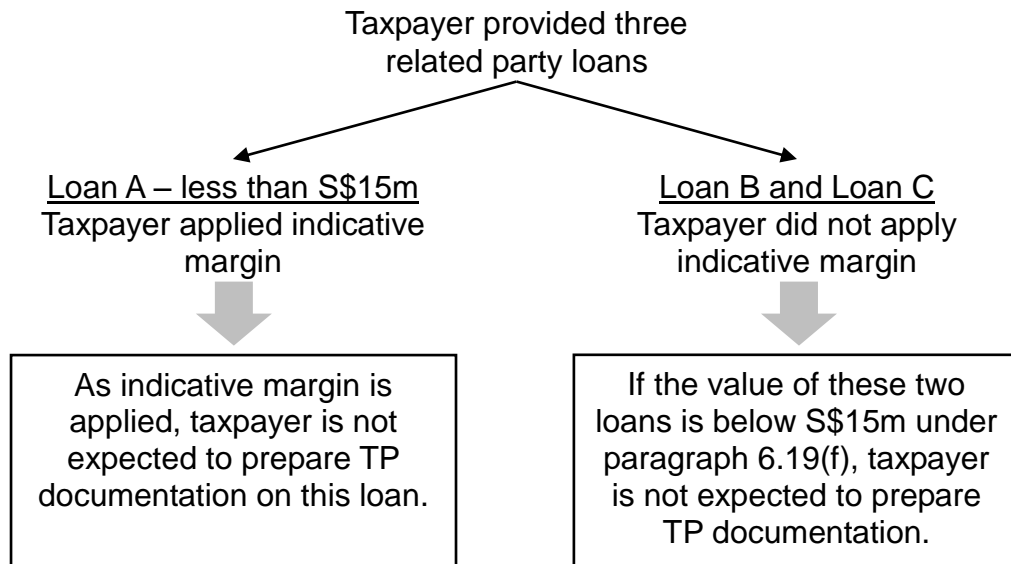
¹⁷ SGS yield is available at <http://www.sgs.gov.sg>

13.34 For floating rate loans, some examples of base reference rates include the SIBOR and LIBOR.

TP documentation

13.35 If taxpayers choose to apply the indicative margin for their related party loans, they are not expected to prepare TP documentation under section 6 for such loans. Such loans will also be excluded from the loan threshold of S\$15 million under paragraph 6.19(f).

Example:



14 Attribution of profit to permanent establishment

Introduction

14.1 This section explains that no further attribution of profits to the permanent establishment is required when certain conditions are met.

Attribution of profit to permanent establishment (“PE”)

14.2 At times, the activities performed by a taxpayer for its foreign related party create for the foreign related party a PE in Singapore. As such, profits that are attributable to the PE will be liable to tax in Singapore.

14.3 However, if the following conditions are met, there will be no further attribution of profits to the PE and thus, there will be no additional Singapore tax liability for the foreign related party:

- (a) The taxpayer receives an arm’s length remuneration from its foreign related party that is commensurate with the functions performed, assets used and risks assumed by the taxpayer;
- (b) The remuneration paid by the foreign related party to the taxpayer is supported by adequate TP documentation to demonstrate compliance with the arm’s length principle; and
- (c) The foreign related party does not perform any functions, use any assets or assume any risks in Singapore, other than those arising from the activities carried out by the taxpayer.

PART IV – MISCELLANEOUS

15 Contact information

- 15.1 If you have any enquiries or need clarification on this Guide, please email ct_transfer_pricing@iras.gov.sg.
- 15.2 If you wish to initiate a pre-filing meeting for an APA or MAP request, please contact IRAS, International Tax Branch.

16 Updates and amendments

	Date of amendment	Amendments made
1	06 January 2015	<p>Updated the section on the arm's length principle (i.e. section 5 in this guide) to provide more guidance including:</p> <ul style="list-style-type: none"> • Other relevant aspects of a comparability analysis including: <ul style="list-style-type: none"> ○ Evaluating transactions on a separate or aggregate basis; ○ Selecting comparables; ○ Using multiple year data; and ○ Considering losses. • Application of TNMM including: <ul style="list-style-type: none"> ○ Choice of net profit indicator or profit level indicator; and ○ Use of Berry ratio. <p>Updated the section on TP documentation (i.e. section 6 in this guide) to provide more comprehensive guidance on TP documentation.</p> <p>Updated the section on TPC (i.e. section 7 of this guide) including:</p> <ul style="list-style-type: none"> • Providing a flowchart of the TPC process; and • Removing the outdated Transfer Pricing Questionnaire. <p>Updated the sections on avoiding and resolving transfer pricing disputes, MAP and APA processes (i.e. sections 8 to 10 in this guide) to provide more guidance including:</p> <ul style="list-style-type: none"> • Annual compliance report for APA; • Minimum information required for pre-filing meetings; and • A sample of letter of authority and APA agreement. <p>Inserted a new section (i.e. section 11 in this guide) regarding IRAS' position on the adjustments relating to transfer pricing.</p> <p>Updated the section on related party services (i.e. section 12 in this guide) to provide clearer guidance on the application of the arm's length principle to related party services. The revised section also includes information that is already available at IRAS' website.</p>

	Date of amendment	Amendments made
		<p>Updated the section on related party loans (i.e. section 13 in this guide) to provide clearer guidance on the application of the arm's length principle to related party loans.</p> <p>Inserted a new section (i.e. section 14 in this guide) on IRAS' position regarding attribution of profit to PE. This information is already available at IRAS' website.</p>
2	04 January 2016	<p>IRAS has enhanced the guidance on cost plus method and amended paragraphs 5.53, 5.54 and 5.56 to 5.58 accordingly.</p> <p>IRAS has enhanced the MAP and APA process and amended the relevant paragraphs in sections 8 to 10 as follows:</p> <ul style="list-style-type: none"> • Replaced the general rule regarding when a financial year is considered a roll-back year in paragraph 8.19 with examples on the APA period and roll-back years. • Added a sentence at the end of paragraph 8.29 that IRAS is not precluded from conducting an audit on the taxpayer if there is non-compliance with the Singapore tax law. • Amended the diagram on the MAP process in paragraph 9.2 to make it clearer. • Amended paragraphs 10.2, 10.5 to 10.7, 10.10, 10.15 and 10.16 to reflect the enhanced APA process. • Rearranged and amended the items in Annex B2 to reflect the changes in paragraph 10.5. <p>Other amendments:</p> <ul style="list-style-type: none"> • Made minor grammatical amendments to paragraphs 6.9, 11.8 and 14.3(c). • Added a sentence at the end of paragraph 13.5 that taxpayer receiving a loan should likewise apply the arm's length principle. • Amended the contact in paragraph 15.1 with the removal of the International Tax Branch's mailbox.
3	12 January 2017	<p>IRAS has enhanced the guidance on arm's length principle and functional analysis, and amended the relevant paragraphs in section 5 as follows:</p> <ul style="list-style-type: none"> • Amended paragraph 5.1 to mention that profits should be taxed where the real economic

	Date of amendment	Amendments made
		<p>activities generating the profits are performed and where value is created.</p> <ul style="list-style-type: none"> • Rearranged and amended paragraphs 5.14(b), 5.20 to 5.23 to provide guidance on risk analysis. <p>IRAS has enhanced the guidance on TP documentation and amended the relevant paragraphs in section 6 as follows:</p> <ul style="list-style-type: none"> • Amended paragraph 6.9 to make reference to the e-Tax guide on Country-by-Country Reporting. • Amended paragraphs 6.11(c) and 6.13(c) to include APAs and other tax rulings in the TP documentation at Group Level and Entity Level. • Inserted paragraph 6.19(d) where taxpayer applies the indicative margin for related party loans. • Amended 6.13(d) (i.e. 5th bullet) and 6.19(f) (i.e. examples on all other categories of related party transactions). <p>IRAS has enhanced the guidance on MAP and APA and amended sections 8 to 10 accordingly. Main amendments are in:</p> <ul style="list-style-type: none"> • Footnote 12, paragraphs 8.6, 8.22, 8.26, 8.29, 8.35, 8.36, 9.11, 9.13, 9.15(c) and 9.16 for MAP. • Paragraph 8.13 on compulsory spontaneous exchange of information on cross-border unilateral APAs. • Paragraphs 8.17 to 8.19 on the roll-back years. • Paragraph 8.47 – this sentence is previously in paragraph 8.29. • Paragraph 10.14 on the information to be included in the APA application. <p>IRAS has put in place an indicative margin for related party loans. The guidance is provided in paragraphs 13.27 to 13.35.</p> <p>Other amendments:</p> <ul style="list-style-type: none"> • Inserted footnote 6 on OECD Actions 8-10: 2015 Final Reports on Aligning Transfer Pricing Outcomes with Value Creation. • Inserted paragraph 15.2 on the IRAS' contact if taxpayers wish to initiate a pre-filing meeting for APA or MAP.

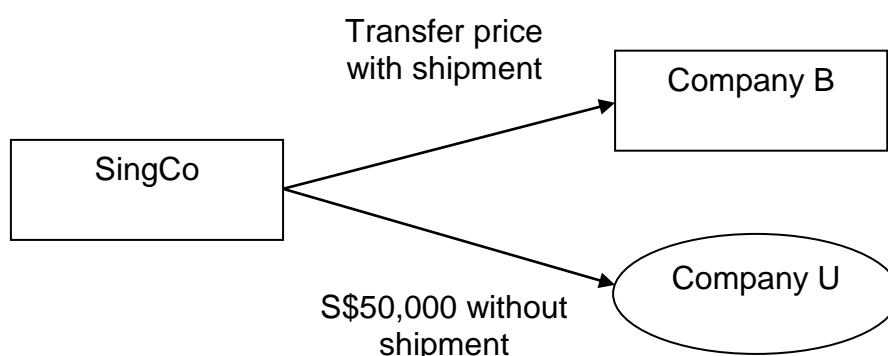
ANNEX A – Examples on transfer pricing methodology

Example 1: CUP method using internal CUP

SingCo, a Singapore company, sells only one type of computer disk drive. The disk drives are sold to two other companies:

- 1) SingCo's overseas subsidiary, Company B, and
- 2) A local unrelated company, Company U.

Under the agreement between SingCo and Company B, SingCo will ship the hard disks to Country B where Company B is located on a CIF basis. On the other hand, Company U takes possession of the hard disks at SingCo's factory.



Assuming that the volume of SingCo's disk drive sales to both parties, and market and economic conditions are similar in any one particular period, the CUP for the disk drives sold to Company B could be computed as follows:

Price of disk drives sold to Company U (per container of goods)	S\$50,000
Add: Adjustment for insurance and freight	<u>S\$ 400</u>
Transfer price (per container of goods) based on CUP	<u>S\$50,400</u>
	=====

Example 2: CUP method using external CUP

SingCo, a Singapore company, sells a commodity product to its overseas subsidiary, Company A, which is located in Country A. This commodity product is widely and competitively traded in Country A. Therefore, the price of the commodity at any point in time is easily available.

In this case, the market price would be the CUP to determine if the transfer price between SingCo and Company A is at arm's length.

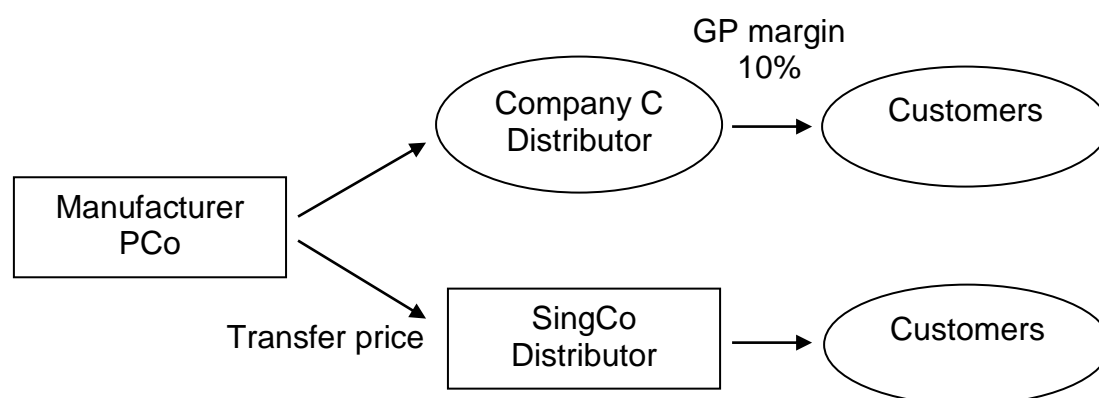
The market price adopted in the above example is commonly termed as "external CUP". Many taxpayers tend to rely on such external data in their attempts to locate comparable independent party transactions.

However, internal comparable transactions (commonly termed as "internal CUP") may have a more direct and closer relationship to the transaction under review as compared to external CUP. As can be seen in the earlier example (Example 1), the internal CUP may arise where the taxpayer buys or sells the particular product, in similar quantities and under similar terms to independent parties in similar markets.

Example 3: Resale price method

SingCo distributes laptop computers in Singapore for its overseas parent company, PCo. Company C, a Singapore company unrelated to PCo, has also been appointed by PCo to distribute desktop computers for it in Singapore.

In this example, it is assumed that the laptop and desktop markets are similar in Singapore. The main difference between the two distributorship agreements is that SingCo performs promotional and marketing functions for PCo whereas Company C does not.



The gross profit margin of Company C from the resale of desktops to consumers was found to be 10%.

The arm's length price for the related party transaction is computed as follows:

SingCo's sales of laptop to unrelated parties	S\$ 3,500
Less: Arm's length resale price margin based on Company C's transactions (10% x S\$3,500)	<u>S\$ 350</u>
	S\$3,150
Less: Arm's length price for promotional and marketing functions performed by SingCo for PCo based on transfer pricing analysis	<u>S\$80</u>
Transfer price (based on resale price method)	<u>S\$3,070</u>
	=====

The above example is based on an internal comparable. PCo's transactions with Company C, an independent party, are used to benchmark the transactions with SingCo (a related party).

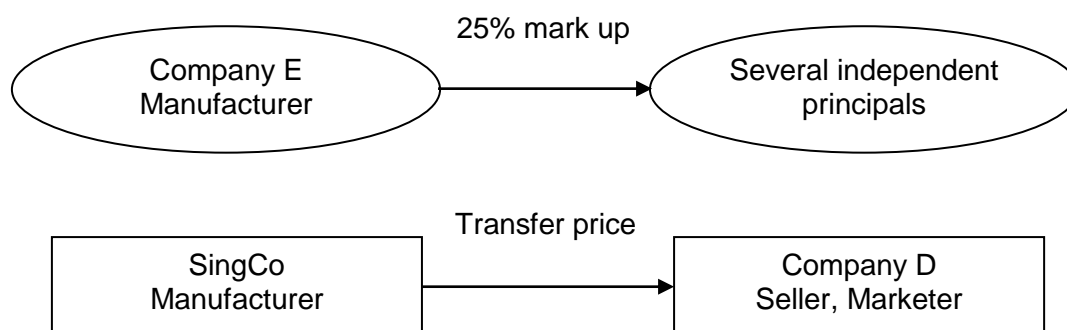
If there are no reliable internal comparables, the same analysis above could be undertaken using external comparables i.e. benchmarking the related party transactions between PCo and SingCo against comparable transactions between an independent manufacturer and an independent distributor.

Example 4: Cost plus method

SingCo is a domestic manufacturer of a specialised drug for its overseas related company, Company D. The MNE group to which SingCo and Company D both belong is the inventor of the drug and the only producer in the world.

Under the agreement, Company D provides all the know-how used in the manufacturing of the drug and undertakes to acquire a fixed output from SingCo every month. Payment is to be made based on the costs incurred by SingCo, along with a mark up to reflect a profit element for SingCo. Based on SingCo's financial statements, the cost incurred to manufacture one unit of the drug is S\$70.

SingCo essentially performs the role of a contract manufacturer. An unrelated Singapore manufacturing company in the pharmaceutical industry that manufactures a different drug, Company E, has been identified as a potential comparable company. Company E charges an average mark up of 25% for providing similar contract manufacturing services to several other independent companies.



The transfer price for the related party transaction is computed as follows:

Direct and indirect cost incurred by SingCo to manufacture one unit of drug	S\$70.00
Arm's length mark up (25% x S\$70.00)	<u>S\$17.50</u>
Transfer price (based on the cost plus method)	<u>S\$87.50</u>
	=====

The above example is based on an external comparable. SingCo's transactions with Company D, a related party, are benchmarked against the transactions between Company E and independent parties.

If reliable internal comparables exist, the same analysis should be undertaken using internal comparables. SingCo's related party transactions with Company D are benchmarked against comparable transactions between SingCo and an independent party

Example 5: Transactional profit split method (residual analysis approach)

SingCo is a Singapore manufacturing and sales company for telecommunication products. It developed an original microprocessor and holds the patent for the manufacturing technology. Company F, an overseas subsidiary of SingCo, develops and manufactures mobile equipment using the new microprocessor as well as technology developed by itself.

Company F is the only manufacturer licensed by SingCo to use the new microprocessor. SingCo purchases all of the mobile equipment manufactured by Company F and sells them to third parties.

Both companies contribute to the success of the mobile equipment through their design of the microprocessor and the equipment. As the nature of the products is very advanced and unique, the group is unable to locate any comparable with similar intangible assets. Therefore, neither the traditional methods nor the TNMM is appropriate in this case.

Nevertheless, the group is able to obtain reliable data on handphone contract manufacturers and equipment wholesalers without unique intangible property in the telecommunication industry. The manufacturers earn a mark up of 10% while the wholesalers derive a 25% margin on sales.

SingCo's and Company F's respective share of profit is determined in two stages using the transactional profit split method (residual analysis approach).

Stage 1 – Determining the return for routine contributions

The simplified accounts of SingCo and Company F are shown below:

	Company F (S\$)	SingCo (S\$)
Sales	100	125
Cost of Goods Sold	(60)	(100)
Gross Margin	40	25
Sales, General & Admin	(5)	(15)
Operating Margin	35	10

The total operating profit for the group is S\$45.

Company F

Cost of goods sold	S\$60
Cost mark up of contract manufacturer (10% x S\$60)	<u>S\$6</u>
Transfer price based on comparables (without intangibles)	<u>S\$66</u>
	====

SingCo

Sales to third party customers	S\$125
Resale margin of wholesalers comparables (without intangibles)	<u>25%</u>
Resale margin (or gross margin)	S\$31.25
	=====

Computation of return for routine contributions based on comparables (without intangibles):

	Company F (S\$)	SingCo (S\$)
Sales	66	
Cost of Goods Sold	(60)	
Gross Margin	6	31.25
Sales, General & Admin	(5)	(15.00)
Routine operating margin	1	16.25

The total operating margin of the group is S\$17.25.

Stage 2: Dividing the residual profit

The residual profit of the group = S\$45 – S\$17.25 = S\$27.75

On further study of the two companies, two particular expense items, research and development (“R&D”) expenses and marketing expenses, are identified as contributing to the key intangibles critical to the success of the mobile equipment. The R&D expenses and marketing expenses incurred by each company are as follows:

SingCo	S\$12 (80%)
Company F	S\$3 (20%)

Assuming that the R&D and marketing expenses are equally significant in contributing to the residual profit, based on the proportionate expenses incurred:

SingCo’s share of residual profit (80% x S\$27.75)	S\$22.20
	=====
Company F’s share of residual profit (20% x S\$27.75)	S\$ 5.55
	=====

Therefore, the adjusted operating profits of each company are as follows:

SingCo	=	S\$22.20 + S\$16.25	=	S\$38.45
Company F	=	S\$5.55 + S\$1	=	S\$6.55

The adjusted tax accounts are as follows:

	Company F (S\$)	SingCo (S\$)
Sales	71.55	125.00
Cost of Goods Sold	(60.00)	(71.55)
Gross Margin	11.55	53.45
Sales, General & Admin	(5.00)	(15.00)
Operating Margin	6.55	38.45

Hence, the transfer price determined using the transactional profit split method (residual analysis approach) should be S\$71.55.

Example 6: Transactional net margin method

SingCo is a Singapore manufacturer of dishwashers. All of SingCo's dishwashers are sold to an overseas related party, Company G, and bear Company G's brand. Company G, a household electrical appliances brand name, sells only dishwashers manufactured by SingCo.

The CUP method is not applied in this case because no reliable adjustments can be made to account for differences with similar products in the market.

After the appropriate functional analysis, SingCo was able to identify a Singapore manufacturer of home electrical appliances, Company H, as a suitable comparable company. However, Company H performs warranty functions for its independent wholesalers, whereas SingCo does not. Company H realises a net mark up or operating margin of 10%.

As the costs pertaining to the warranty functions cannot be separately identified in Company H's accounts and no reliable adjustments can be made to account for the difference in the functions, it may be more reliable to examine the net margins in this case. The transfer price for SingCo's sale of dishwashers to Company G is computed using the TNMM as follows:

SingCo's cost of goods sold	S\$5,000
SingCo's operating expenses	<u>S\$1,500</u>
Total costs	S\$6,500
Add: Net mark up (10% x S\$6,500)	<u>S\$650</u>
Transfer price based on TNMM	<u>S\$7,150</u>
	=====

ANNEX B – Samples and guides for MAP and APA process

Annex B1: Sample of letter of authorisation

Note: The letter is to be printed on the taxpayer's letterhead

[Date]

Tax Policy and International Tax Division
International Tax Branch
Inland Revenue Authority of Singapore
55 Newton Road
Singapore 307987

Attention: [IRAS Case Officer]

LETTER OF AUTHORITY- APPLICATION FOR *[MUTUAL AGREEMENT PROCEDURE (“MAP”)/ BILATERAL ADVANCE PRICING ARRANGEMENT (“BAPA”)/ UNILATERAL ADVANCE PRICING ARRANGEMENT (“UAPA”)] BY [NAME(S) OF TAXPAYER(S)]

Dear Sir/ Madam,

This is to advise that we have appointed [Tax agent/ representative (Name and contact information)] to represent us on all matters relating to the above application. We authorise IRAS to communicate with them and the parties listed below via letters, phone calls, **[electronic means (e.g. emails)], etc. on all matters relating to the above application.

- (i) [Authorised party (Name and contact information)]
- (ii) [Authorised party (Name and contact information)]

Yours faithfully,

[Name of signatory]
[Designation of signatory]
Name of taxpayer

* Please delete accordingly.

** Please delete if you do not wish that the electronic mode of communication be used for the above application.

Annex B2: Guide on minimum information required for pre-filing meeting

S/No.	Minimal Information for pre-filing meeting	MAP	APA
1	Letter of authorisation stating the engagement of tax agents or other representatives to act for the taxpayer	✓ (where applicable)	✓ (where applicable)
2	Taxpayer's name, address, tax identification number and contact details	✓	✓
3	Whether request is for unilateral, bilateral or multilateral APA		✓
4	The foreign competent authority if the request is not relating to unilateral APA	✓	✓
5	Financial years covered / to be covered ("covered period")	✓	✓ (including roll-back years)
6	A brief description of the transactions involved ("covered transactions")	✓	✓
7	The related parties to the transactions ("covered entities")	✓	✓
8	Whether the transfer pricing issue is or will be adjudicated in the courts of the foreign jurisdiction	✓	
9	How the covered transactions relate to the overall business activities of the covered entities	✓	✓
10	A detailed organisation chart	✓	✓
11	An overview of the functions undertaken, assets employed and risks assumed by the covered entities during the covered period	✓	✓
12	A highlight of how the functions undertaken, assets employed and risks assumed by the covered entities have changed compared to the period prior to the MAP/ proposed APA period	✓	✓
13	Based on the preliminary or completed transfer pricing analysis, list down the proposed: (a) tested party; (b) transfer pricing methodology;	✓	✓

S/No.	Minimal Information for pre-filing meeting	MAP	APA
	(c) profit level indicator, if relevant; and (d) arm's length result		
14	Foreign competent authority's audit summary if available: (a) transfer pricing methodology and the reasons for its selection; (b) the choice of tested party; (c) the profit level indicator; (d) the arm's length result; (e) adjustment made; and (f) amount of tax involved	✓	
15	Whether the taxpayer has made corresponding adjustments in its Singapore income tax return	✓	
16	List of critical assumptions under which the proposed APA will operate		✓
17	Any other information which is of relevance	✓	✓

Annex B3: Sample of an APA agreement

APA Terms	Description and examples
Covered entities	<p>This refers to the related parties to the covered transaction.</p> <p><u>Example:</u> Singapore entity : ABC Pte Ltd Tax treaty entity : XYZ Ltd</p>
Covered transaction(s)	<p>This refers to the transactions on which an arm's length remuneration is to be agreed.</p> <p><u>Example:</u> Sales of products from XYZ Ltd to ABC Pte Ltd</p>
Covered period	<p>This refers to the FYs to be covered in the APA.</p> <p><u>Future FYs</u> Generally up to 5 FYs</p> <p><u>Roll-back years (if applicable)</u> Generally up to 2 FYs</p>
Transfer pricing method	<p>This is the agreed method on which the arm's length remuneration is to be determined.</p> <p><u>Example:</u> Tested party is ABC Pte Ltd Transfer pricing method is transactional net margin method ("TNMM") with operating margin ("OM") as the profit level indicator</p>
Arm's length remuneration	<p>This is the agreed arm's length remuneration for the covered transaction.</p> <p><u>Example:</u> Inter-quartile OM range of D% to E%</p>
Compensating adjustment rules	<p>The rules set out the basis of determining the compensating adjustments.</p> <p><u>Example:</u> To adjust the actual OM to the nearest edge of inter-quartile OM range if the actual OM is not within the range</p> <p>For example, if actual OM is below D%, to adjust the OM up to D%. If actual OM is above E%, to adjust the OM down to E%.</p>

APA Terms	Description and examples
Critical assumptions	<p data-bbox="596 237 730 271"><u>Example:</u></p> <p data-bbox="596 271 1430 304">No material changes throughout the covered period to the:</p> <ul data-bbox="596 344 1442 678" style="list-style-type: none"> <li data-bbox="596 344 1442 416">• economic environment in which the covered entities operate. <li data-bbox="596 456 1442 566">• functions performed, risk assumed and assets employed by the covered entities with respect to the covered transaction. <li data-bbox="596 607 1442 678">• accounting methods and business operations of the covered entities with respect to the covered transaction.
Annual compliance report	<p data-bbox="596 721 1442 860">The covered entities are to submit the annual compliance report, including computations, to demonstrate compliance with APA terms by the filing due date of covered entities' income tax returns.</p>
Others	<p data-bbox="596 904 1038 938">Any other terms and conditions</p>

Annex B4: Guide on annual compliance report

The following information may be included to demonstrate compliance with APA terms and critical assumptions:

1. A comparison between the tested party's actual results and the agreed arm's length remuneration in the agreement.
2. A statement on whether the tested party's actual results fall within or outside the arm's length remuneration.
3. An analysis on the factors that cause the tested party's actual results to fall outside the arm's length remuneration as well as calculation of the compensating adjustments.
4. A statement on whether the remaining APA terms have been fully complied.
5. Description of any failure to comply with the remaining APA terms.
6. A statement on whether there are significant changes to any aspects of the taxpayer's business.
7. Description of the significant changes and an analysis of their impact on the APA agreement.
8. A statement on whether any of the critical assumptions may not be valid.
9. Description of the reason why any critical assumptions may not be valid and a proposed course of action.

ANNEX C – Routine support services commonly provided on an intra-group basis

Accounting and auditing

Maintenance of accounting records, preparation of financial statements based on such records, reconciliation of financial data and ensuring authenticity and reliability of accounting records, etc., including performance of operational and financial internal audits.

Accounts receivable and accounts payable

Collation and verification of data on accounts receivable and accounts payable for the purposes of financial reporting, aging, billing, soliciting payments from customers, payment to vendors and procurement, etc.

Budgeting

Compilation of data for purposes of preparing budget estimates, reports, etc.

Computer support

Provision of technical assistance services such as trouble-shooting support in relation to usage of computer hardware and software, maintenance of IT infrastructure, etc.

Database administration

General maintenance of computer databases including data storage, but excluding analytic services performed on stored data.

Employee benefits

Administration of employee compensation and benefit plans e.g., healthcare, life insurance, dental, employee incentive compensation, profit sharing, etc., and co-ordination with external parties such as hospitals, insurers, etc. to implement such benefit plans.

General administration

Performance of clerical and administrative functions such as general purchasing, data entry, photocopying/ scanning of materials, scheduling appointments, word processing, maintenance of file registry, etc.

Legal services

Provision of general legal services by in-house legal counsel.

Payroll

Compilation and verification of employees' time worked and claims for reimbursable expenses to compute the salaries, commissions and reimbursements due to employees. It includes the preparation of pay cheques and arrangement for the crediting of such payments into employees' bank accounts.

Corporate communications

Handling of internal and external communications relating to corporate policies.

Staffing and recruiting

Management of staffing requirements, performance issues and staff welfare in the organisation or group and the implementation of recruitment plans such as publicising open positions and screening of candidates, etc.

Tax

Preparation of various tax returns, computations, reclaim forms and responses to queries for submission to tax authorities and the processing of tax payments, etc.

Training and employee development

Management and implementation of training and development programmes for employees.