APAC News

1 October 2009
Volume 1, Issue 3

Special Edition: Transfer Pricing

Welcome to the third issue of our Asia Pacific (APAC) Regional Newsletter.

In this special edition, we reviewed the development in Transfer Pricing (TP) across the APAC region.

The comparative table below illustrates the differences in the current status of TP development in each of the APAC countries reviewed.

However, as can be seen from the individual country profiles, all the APAC countries reviewed are moving towards the same direction in respect to TP requirements and enforcement.

This seems to indicate that the resolutions from the G20 summit in April 2009 are taking effect in the APAC region.

TP development across the APAC Region.

Country Profile:

Comparative Table

	Australia	China	Hong Kong	Indonesia	Malaysia	Mauritius	Singapore	South Korea
1. TP Legislation	5	5	1	3	3	1	2	5
2. Guidance on TP Methods	5	4	1	4	5	1	5	5
3. TP Documentation Requirements	5	5	1	3	3	1	3	5
4. Level of Enforcement by Tax Authorities	5	3	1	2	4	2	3	5
5. Cross-border Treaties for Tax Disputes	5	4	1	2	3	2	3	5
(None / Low) 0 ----------> 5 (Comprehensive / High)								

Special points of interest:

- Australia and South Korea currently have the most detailed TP regime and one of the widest tax treaty network
- Malaysia and Singapore have provided detailed guidance to taxpayers prior to strengthening their TP legislation

AUSTRALIA

SAWARD DAWSON
chartered accountants

Stantons International

Transfer Pricing Legislation

Australia's domestic income tax legislation and double tax agreements reflect the OECD approach to transfer pricing. The specific transfer pricing provisions are contained in Division 13 of the Income Tax Assessment Act (1936). However, these provisions are subject to the International Agreements Act and the provisions in Australia's double tax agreements. The general anti-avoidance provisions in Part IVA of the Income Tax Assessment Act (1936) are also applicable.

Guidance from Tax Authorities

The Australian Taxation Office (ATO) has issued various public rulings on transfer pricing. In particular, Taxation Ruling TR 97/20 sets out acceptable methodologies and when they are considered appropriate.

Acceptable methodologies are the traditional transactional methods (comparable uncontrolled price method, resale price method and cost plus method) and the transactional profit methods (profit split method and transactional net margin method). However, the ATO may accept other approaches where there are no comparable dealings or insufficient data to allow the preferred methods to be applied. The global formulary apportionment method is not accepted.

In the recent Administrative Appeal Tribunal decision (*Roche Product* case) the Commissioner of Taxation adopted the transactional net margin method (TNMM) to assess the taxpayer, however, the tribunal refused to adopt TNMM and effectively used the resale price method instead.

As such, taxpayers should ensure that they are able to justify that the method they have adopted is the most appropriate or most suited to their circumstances.

"… taxpayers should ensure they are able to justify the method that they have adopted …"

Documentation Requirements

The tax legislation does not specifically state what records are required. However, the ATO has published its expectations of documentation in Taxation Ruling TR 98/11. This ruling contains a four step process:

1. Accurately characterise the international dealings between the associated enterprises in the context of the taxpayer's business and document that characterisation.
2. Select the most appropriate transfer pricing methodology or methodologies and document this choice.
3. Apply the most appropriate method and determine the arm's length outcome and document the process.
4. Implement support processes. Install review process to ensure adjustment for material changes and document these processes.

Where the aggregate amount of transactions or dealings with international related parties (including loans) exceeds AUD1 million in the financial year, the taxpayer must complete a transfer pricing schedule (Schedule 25A) as part of their income tax return.

Included on this schedule is a requirement to disclose the level of compliance with steps 1, 2 and 3 and which methodologies have been applied.

"… taxpayer must complete a transfer pricing schedule as part of their income tax return."

Enforcement by Tax Authorities

AUSTRALIA

(Continued)

Transfer pricing is a significant audit focus area by the ATO and both SMEs and large corporates are targeted.

The ATO has stated in its compliance program for 2009-10 that it would focus on the use of arrangements between Australian and offshore entities, including branches to shift profits and tax from Australia to other countries.

Arrangements specifically identified include:

- Restructuring Australian-based operations to shift functions, assets and risks offshore on a non-arm's length basis, such as the sale of intellectual property at a nominal price
- Paying excessive interest, guarantee and other fees
- Provision of services by Australian-headquartered companies to overseas subsidiaries at no charge
- Allocating income and expenses to Australian businesses which are inconsistent with the economic activities conducted

Disputes are invariably resolved directly between the taxpayer and the ATO and cases rarely come before the courts. Consequently there is little available data on revenue raised specifically from transfer pricing audit activity. However, in 2006, the Commissioner of Taxation stated that since 1998, the ATO had raised in excess of AUD1.7 billion in tax and penalty adjustments from transfer pricing audits. In addition, there were disallowed losses of around AUD1.9 billion.

In addition, the Australian government has committed AUD122 million in budget allocation over the next 3 years to the ATO and partner agencies to continue to investigate and prosecute tax haven abuse through Project Wickenby.

Project Wickenby, which is a cross-agency initiative, was implemented in 2005 to combat tax evasion through offshore schemes. To date, Project Wickenby has raised AUD406 million in tax liabilities and collected AUD117 million in cash.

"… Australian government has committed AUD122 million … to continue to investigate and prosecute tax haven abuse …"

Agreements with other Jurisdictions on Tax Disputes

Advance Pricing Arrangements (APAs)

It is possible for a taxpayer to negotiate an APA with the ATO and, where appropriate, the foreign tax authority.

The ATO has issued Taxation Ruling TR 95/23 explaining the procedures for bilateral and unilateral APAs.

As at 31 May 2009, there were 67 agreements with large businesses and 59 with SMEs.

Double Tax Agreements

Most of Australia's Double Tax Agreements contain mutual agreement procedure (MAP) provisions to address double taxation issues.

In 2007 the tax laws were amended to provide a mechanism to give effect to Australia's treaty obligations to provide relief from economic double taxation arising from transfer pricing adjustments.

Tax Information Exchange Agreements

Australia has also signed tax information exchange agreements with Bermuda, Antigua and Barbuda, the Netherland Antilles, the British Virgin Islands, the Isle of Man, Jersey, Gibraltar and Singapore. These agreements contain a mechanism for resolving transfer pricing disputes.

For enquiries on this article, please contact:

Melbourne
Ms Cathy Braun
cathy@sawarddawson.com.au

Perth
Mr John Van Dieren
jvdieren@stantons.com.au

"… 67 (APA) agreements with large businesses and 59 with SMEs."

CHINA

Russell Bedford

Serving Hong Kong Since 1994

Transfer Pricing Legislation

Chapter 6 "Special Tax Adjustments" of the new Enterprise Income Tax Law ("EIT Law") and its Implementation Regulations which are effective from 1 January 2008 are the main legislation governing Transfer Pricing in China.

A comprehensive Tax Circular, *Guoshuifa* [2009] No.2, on the Implementation Measures for Special Tax Adjustments ("STA Measure") was issued by the State Administration of Taxation ("SAT") on 8 January 2009 which takes effect retrospectively from 1 January 2008.

Guidance from Tax Authorities

Article 49 of the EIT Law confirms that related party transactions ("RPTs") should comply with the arm's length principle. This is elaborated by Article 111 of the Implementation Regulations which sets out the appropriate or reasonable methods which the local tax authorities can use as a basis for tax adjustments as empowered by Article 41 of the EIT Law:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Transaction Net Margin Method
- Profit Split Method
- Other Methods consistent with the arm's length principle

Unlike the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and the Best Method Rule contained in the US Transfer Pricing Regulations which endorsed certain methods as the preferred methods, no such endorsement has been made in the transfer pricing laws of China.

The STA Measures provide some general guidelines on the suitability of each of the transfer pricing methods. Taxpayers are required under Article 14 of the STA Measures to justify their selection of transfer pricing methods in their contemporaneous documentations.

No "preferred methods" endorsed in the "transfer pricing laws of China."

Documentation Requirements

The STA Measures confirmed the annual disclosure requirements as well as the contemporaneous documentation requirements.

Annual Disclosure of Related Party Transactions

Article 11 of the STA Measures prescribed 9 disclosure forms on RPTs which must be submitted together with the annual tax return which is due for submission within 5 months after the end of each year.

These forms require disclosure on the following:

1. Related Parties
2. Summary of RPTs
3. Sale and Purchase
4. Services
5. Intangible Assets
6. Fixed Assets
7. Financing
8. Outbound Investment
9. Outbound Payment

Contemporaneous Documentation Requirements

Article 14 of the STA Measures provide details of the contemporaneous documentation which all enterprises, unless exempt by the STA Measures, must prepare, maintain and submit upon request for each tax year. The contemporaneous documentation should include the 5 main categories and the 26 sub-categories as prescribed by the STA Measures. Those 5 main categories are:

Continue on page 5

"9 disclosure forms on RPTs which must be submitted together with the annual tax return … "

Documentation Requirements (Continued)

Continued from page 4

1. Organisation Structure
2. Description of Business Operations
3. Description of RPTs
4. Comparability Analysis
5. Selection and Application of Transfer Pricing Method

Exemptions

The following are exempt from the contemporaneous documentation requirements:

- Annual RPTs of tangible goods and intangibles are less than Rmb200M and Rmb40M respectively;
- RPTs are covered by an Advance Pricing Arrangement ("APA"); or
- The taxpayer is less than 50% foreign-owned and does not have cross-border RPTs

RPTs covered under an APA or Cost Sharing Arrangement ("CSA") implemented during the year are excluded from the above exemption threshold calculation.

However, contemporaneous documentations relating to thin capitalisation, APAs and CSAs are still required to support the arm's length nature of the transactions in those arrangements.

Filing Requirements

The contemporaneous documentation must be completed by the 31 May of the following year.

Although the deadline for 2008 tax year is extended to 31 December 2009, enterprises must declare in one of the 9 forms submitted by 31 May 2009 whether contemporaneous documentation has been prepared to support the enterprise's transfer pricing policy for the year.

Upon request by the tax authorities, the enterprise must submit its contemporaneous documentation within 20 days.

In addition, the contemporaneous documentation submitted must be in Chinese.

"Upon request … the enterprise must submit its contemporaneous documentation within 20 days."

Enforcement by Tax Authorities

China has enacted and enforced laws on transfer pricing since the 1990s.

The previous Income Tax Law for foreign investment enterprises and foreign enterprises ("FEIT Law") and its Implementation Regulations enacted in 1991 already contained provisions which authorise the tax authorities to make tax adjustments if non-arm's length prices were used.

Interestingly, the burden of proving that a transaction was not at arm's length prices used to be on the tax authorities. However, since the issue of *Guoshuifa* (1998) No.59, which is now superseded by the STA Measures, the burden of proof has shifted to the taxpayer.

The new Income Tax Law consolidates many of the previous provisions and also provides more details on areas such as APA, CSA, Thin Capitalisation Rule and General Anti-avoidance Rules ("GAAR").

The local tax authorities are charged with the responsibility of carrying out the transfer pricing audits, although the results of all transfer pricing audits must ultimately be approved at the national level, by the SAT.

Per Article 29 of the STA Measures, transfer pricing investigation would focus on the following types of enterprises:

1. Significant amounts of RPTs
2. Continuous losses, low or fluctuating profitability
3. Profit levels lower than industry levels
4. Profit levels not correspond with functions performed and risks assumed
5. Engage in RPTs where the related party is incorporated in a tax haven

Continue on page 6

The new Income Tax Law provides more details on APA, CSA, Thin Capitalisation Rule and GAAR.

CHINA

(Continued)

Enforcement by Tax Authorities (Continued)

Continued from page 5

6. Failure to file RPTs Disclosure Forms or prepare contemporaneous documentations
7. Clearly in breach of the arm's length principle

Agreements with other Jurisdictions on Tax Disputes

"China has an extensive network of double taxation treaties (over 80)"

Double Tax Treaty

China has an extensive network of double taxation treaties (over 80). As they are mainly based on the OECD Model Tax Convention, they would include an article on Mutual Agreement Procedure ("MAP").

If, for example, a tax adjustment resulted in the same profits being taxed by both jurisdictions, the MAP would be the basis on which a resident on one side could seek assistance to remedy the situation.

However, enterprises will have to bear the risk of uncertainty if they rely only on the MAP after a tax adjustment has been imposed by the tax authorities.

Bilateral Advance Pricing Arrangements ("BAPAs")

The SAT encourages multinational companies with significant amounts of RPTs to apply for APAs.

Not only would it help taxpayers to manage their transfer pricing risk and eliminate double taxation, it would also provide to the Chinese tax authorities greater clarity and certainty on the taxpayer's transfer pricing arrangements and help secure future tax revenues.

Since its first BAPA in 2005, China has completed a total of 9 BAPAs involving Japan, United States, Korea and recently Denmark.

The STA Measures provide further guidance on the APA process:

- Eligibility Criteria for APAs
- Annual RPTs over RMB40M
- Complied with RPT Disclosure requirements
- Prepared, maintained and provided contemporaneous documentations
- APAs will cover transactions for three to five consecutive years
- APAs can be rolled back and applied to prior year RPTs if they are identical or similar
- The pre-filing meeting can be conducted anonymously
- For BAPAs or multilateral APAs, formal application to be submitted to both the SAT as well as the local tax authorities (to demonstrate consistency and credibility of the APA program)

For enquiries on this article, please contact:

Mr Jimmy Chung
jimmychung@russellbedford.com.hk

HONG KONG

Russell Bedford

Serving Hong Kong Since 1994

Transfer Pricing Legislation

Currently, Hong Kong does not have a detail set of legislation on Transfer Pricing. The main provisions from the existing Inland Revenue Ordinance ("IRO") relating to transfer pricing are Section 20 and Section 61A of the IRO.

Section 20 empowers the Commissioner of Inland Revenue ("CIR") to assess a non-resident to tax, if the business between the non-resident and a closely connected resident was so arranged that it produces to the resident either no profits or less than the ordinary profits which might be expected to arise in or derive from Hong Kong.

However, Section 20 is rarely used by the Inland Revenue Department ("IRD"), possibly due to the difficulty of enforcing against a non-resident that operates in a different jurisdiction.

In practice, the IRD would invoke Section 61A if it can be proved that the taxpayers entered into a transaction(s) for the sole or dominant purpose of obtaining a tax benefit.

If that can be proven, the IRD can assess the taxpayer by disregarding the transaction(s) or in such manner as it considers appropriate to counteract the tax benefit.

As confirmed in the Court of Final Appeal decision (*Ngai Lik Electronics Limited v CIR*), if the IRD invokes Section 61A to counteract the tax benefit, it must do so with the "necessary degree of precision".

In other words, it should not be able to raise additional assessments on an arbitrary basis.

Guidance from Tax Authorities

There is currently no specific guidance from the IRD on acceptable transfer pricing policies or methods.

The IRD has issued a guidance note in April 2009 ("DIPN 45") on how to seek relief from double taxation due to transfer pricing or profit reallocation adjustment.

In addition, it is understood, and confirmed in DIPN 45, that the IRD will issue another guidance note ("DIPN 46") to explain the basis on which the IRD would make transfer pricing adjustments. In other words, the IRD will publish what it considers to be acceptable transfer pricing policies or methods.

"… the IRD will issue DIPN 46 to explain the basis on which the IRD would make transfer pricing adjustments."

Documentation Requirements

There is currently no mandatory contemporaneous transfer pricing documentation requirements for taxpayers in Hong Kong.

If the IRD challenges a taxpayer on its tax filing, the taxpayer is required to produce information or documentation to support its tax position. This may include transfer pricing documentation, but at present, although it is preferable that such documentation is available, it is not a prerequisite for the IRD to consider the case.

Further, even if it is not mandatorily required in Hong Kong, it is likely that multinational enterprises in Hong Kong will still need to prepare such documents, as a defence against challenges by tax authorities in other jurisdictions.

HONG KONG

(Continued)

Enforcement by Tax Authorities

There is currently no official transfer pricing audits carried out by the IRD in Hong Kong. However, the IRD's Field Audit and Investigation Unit have long been reviewing and investigating taxpayers for understatement of assessable income or profits, which would also include those with non-arm's length transfer pricing policies.

As demonstrated in the above-mentioned *Ngai Lik* case, the IRD would invoke S61A against companies which have adopted new arrangements or structures which appear to be for the sole or dominant purpose of obtaining a tax benefit.

Agreements with other Jurisdictions on Tax Disputes

"… it is likely that Hong Kong's double tax treaty network would expand, once the amendments are approved."

Double Tax Treaty

Hong Kong currently has comprehensive double taxation agreements with Belgium, Luxemburg, Thailand and Vietnam, as well as a comprehensive double taxation arrangement with Mainland China.

It is believed that the reason for the small tax treaty network was due to the fact that Hong Kong would not adopt the 2004 OECD model on Exchange of Information.

However, as the government has already begun the process of amending the legislation to allow the liberalisation of exchange of tax information in Hong Kong, it is likely that Hong Kong's double tax treaty network would expand, once the amendments are approved.

Bilateral Advance Pricing Arrangements ("BAPAs")

There are currently no BAPAs concluded by the Hong Kong government.

However, for business certainty, it is possible to seek an Advance Ruling from the IRD to ascertain whether an arrangement would be caught by Section 61A of the IRO.

For enquiries on this article, please contact:

Mr Ian Lee
ianlee@russellbedford.com.hk

Transfer Pricing Legislation

Legislation on transfer pricing in Indonesia is included in Article 18 of the Income Tax Law (Law No. 36 which was amended in 2008).

Article 18 states that the Director General of Taxes (DGT) is authorised to rectify income and deductions between related parties and as well as to characterise debt as equity for the purposes of the computation of taxable income to assure that the transaction under the fairness and the common business practice not under the effect of special relationship using price comparison method between independent parties, re-sale price method, cost-plus method, or other methods.

In other words, the arm's length principle is adopted and the DGT is authorised to make tax adjustments if transfer prices between related parties are not at arm's length.

Related party relation is considered to exist if:

- a taxpayer having direct or indirect capital participation at least 25% (twenty five percent) of total equity upon other taxpayer; or a relationship between taxpayers through ownership of at least 25% of equity of two or more taxpayers, as well as relationship between two or more taxpayers concerned;
- a taxpayer controlling other taxpayers; or two or more taxpayers controlling directly or being indirectly under the same control;
- a family relationship either through blood or through marriage within one degree of direct or indirect lineage.

Guidance from Tax Authorities

A circular issued by the DGT in 1993 entitled "Guideline of Handling Transfer Pricing Cases" (Circular No. SE-04/PJ.7/1993), provide guidance to tax auditors as to the types of transfer pricing methods for transfer pricing:

a) Comparable uncontrolled price (CUP) method,
b) Cost plus method,
c) Sales minus/resale price method,
d) Comparable profit / return on investment in the same business.

It is noted that the CUP method is generally favoured, however it is hoped that further guidance will be issued at a later date.

"… the CUP method is generally favoured …"

Documentation Requirements

Government Regulation No.80/2007 which was issued on 28 December 2007 and is effective from 1 January 2008, requires taxpayers engaged in transactions under common control to maintain documentation to support that their transfer prices are at arm's length.

However, there are no specific details on the type of documents that are required and what is required to prove that the transactions are at arm's length.

Disclosure in Tax Return

Taxpayers are required to disclose in their annual tax returns details of the related party transactions as well as the method adopted in determining the transfer prices.

One Month Rule

According to the 2007 Tax Administrative Law, documents requested by the Indonesian Tax Office must be submitted within one month.

As such, if transfer pricing documentation is not submitted upon request within one month, it may not be accepted at a later date to dispute or appeal against the tax assessed.

"Taxpayers are required to disclose in their annual tax returns details of the related party transactions as well as the method adopted … "

INDONESIA

(Continued)

Enforcement by Tax Authorities

Specific transfer pricing audits have not been carried out to date. Transfer prices with related parties are usually reviewed as part of the general tax audit.

In addition to cross-border transactions, domestic transactions with group companies may also be challenged to prevent shifting of profits to utilise losses, as offsetting of losses between group companies is not allowed in Indonesia.

A tax refund request will almost always trigger a tax audit. A tax return claiming a tax loss or not filed on time may also trigger a tax audit.

Auditor of Director General of Taxes will make adjustment of tax liability.

Taxpayers need to pay its shortage of tax together with a late penalty of 2% per month for maximum 24 month or 48%.

Surcharges range from 50% to 100% depending on the type of tax that is undercharged.

For criminal cases, fines from 200% to 400% as well as imprisonment may be imposed.

"A tax refund request will almost always trigger a tax audit."

Agreements with other Jurisdictions on Tax Disputes

Article 18 point 3a of Law No. 18 of 2008 stipulated that the DGT is authorised to conclude an agreement with a taxpayer and with a tax authority from another country on transfer pricing method between related taxpayers. However, there is no data showing that bilateral agreement has been made.

For enquiries on this article, please contact:

Mr Defi Satria
defi@russellbedford.co.id

Transfer Pricing Legislation

Prior to 1 January 2009, there were no specific provisions in the Income Tax Act, 1967 (MITA) to combat transfer pricing that were not at arm's length. The Malaysian Inland Revenue Board (MIRB) mainly relied upon the following sections:

S140 – Power to disregard certain transactions

S141 – Powers regarding certain transactions by non-residents

Section 140 is a general anti-avoidance provision used to counteract any transactions that has the direct or indirect effect of reducing or delaying the tax liability of the taxpayer. The Director General of MIRB can disregard the transaction or make adjustment as he thinks fit in order to counteract the effect of the transaction.

Section 141 empowers the Director General of MIRB to assess a non-resident to tax, if the business between the non-resident and a closely-connected resident was arranged in such a way that produces to the resident either no income or a smaller income than that which might be expected to arise from that business.

However, Section 141 has rarely, if ever, been invoked.

Section 140A was enacted and became effective on 1 January 2009. This Section provides the legal basis for the MIRB to make transfer pricing adjustments if arm's length price was not used.

The new Section 140A also specifically introduced thin capitalisation rules.

Guidance from Tax Authorities

The first transfer pricing guidelines were released in July 2003. With the enactment of the new Section 140A, the MIRB is in the process of drafting the transfer pricing regulations which are expected to also cover thin capitalisation. Pending release of the new regulations, the 2003 guidelines are still applicable.

The 2003 guidelines are generally based on the internationally accepted arm's length principle as set out under the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. The guidelines provide five acceptable pricing methodologies. MIRB allows the transactional profit methods (profit split method and transactional net margin method) only when it can be substantiated that the traditional methods (Comparable uncontrolled price method, resale price method and cost plus method) cannot be reliably applied.

The method that requires the fewest adjustments and provides the most reliable measure of an arm's length result is preferred by the MIRB. Methods that are based on global formulary apportionment are not acceptable by MIRB.

"The method that requires the fewest adjustments and provides the most reliable measure of an arm's length result is preferred by the MIRB."

Documentation Requirements

Although there are no specific statutory requirements for transfer pricing documentation, under the Self Assessment System, taxpayers are required by statute to be able to substantiate that its related party transactions have been carried out on an arm's length basis. As such, appropriate and sufficient documentation should be prepared when they submit their tax return (usually within seven months from their year end).

The transfer pricing documentation does not have to be submitted together with the tax returns and taxpayers are not required to declare whether transfer pricing documentation has been prepared.

However, as stated in the transfer pricing guidelines, such documentations have to be made available to the MIRB upon request, usually within 3 to 4 weeks.

Continue on page 12

MALAYSIA

(Continued)

Documentation Requirements (Continued)

Continued from page 11

In addition to the transfer pricing documentation, the MIRB will usually request for additional supporting documents such as agreements, samples of transaction documents (invoices, purchase orders, shipping documents) as well as any other information relating to a specific transaction.

Under the general records keeping rules (Section 82: Duty to keep records and give receipts), taxpayers are required to keep sufficient records for a period of seven years from the end of the year to which income from the business relates.

The transfer pricing guidelines have set out a list of information and documentation to be prepared for transfer pricing purposes.

This list is neither intended to be exhaustive nor meant to apply to all types of businesses.

Instead, taxpayers are advised to maintain information and documentation that are applicable to their circumstances.

Enforcement by Tax Authorities

"Transfer pricing audit is expected to be the focus of MIRB with the introduction of Section 140A."

It is noted that transfer pricing audit activities have increased significantly since the introduction of transfer pricing guidelines.

There is a specific transfer pricing unit within the MIRB to carry out transfer pricing audit. Transfer pricing audit is expected to be the focus of MIRB with the introduction of Section 140A.

The MIRB has carried out many transfer pricing audits, targeting mainly those with substantial related party transactions that have low profit margins, persistent losses or where the counterparty is located in a tax haven.

In addition to multinational companies, the MIRB has also targeted local group companies, since they may be motivated to shift profits to group companies qualifying for tax incentives or tax holidays.

Currently, there is no specific penalty structure on transfer pricing. The existing legislation and penalty structure are applicable. Penalties for transfer pricing adjustments can range from 100% to 300% of the tax undercharged.

Past experiences show that MIRB has adopted the penalty table that was used for tax audit purposes. However, the recent amended tax audit framework has specifically excluded transfer pricing from the general tax audit penalty regime. Specific penalty regime for transfer pricing is expected to be included in the new transfer pricing regulations.

Agreements with other Jurisdictions on Tax Disputes

A new Section 138C which governs Advance Pricing Arrangement (APA) was introduced together with Section 140A.

Under S138C, the Director General of MIRB can enter into an APA with a person who carries out cross border transactions with associated persons. In addition, for countries that Malaysia has double taxation agreements, the competent authorities may also enter into an APA in order to determine the transfer pricing methodology to be used in any future apportionment or allocation of income or deduction to ensure the arm's length transfer prices in relation to that transaction.

Taxpayers are awaiting for the new regulations from the MIRB to provide further clarity on the application of Advance Pricing Arrangement.

For enquiries on this article, please contact:

Mr Loh Kok Leong
lohkl@russellbedford.com.my

MAURITIUS

Transfer Pricing Legislation

Mauritius does not have specific detailed legislations on Transfer Pricing. Transfer pricing is governed by the existing provisions in the Income Tax Act (MITA), namely Sections 75 and 90 of the MITA.

Section 75 empowers the Director-General to assess a non-resident (or a company controlled by a non-resident) to tax if the business carried on in Mauritius is not in the opinion of the Director-General to be at arm's length and produces no net income or less than the amount of net income which might be expected to be derived from that business or activity.

The amount assessed will be the amount which the Director-General determines would have been derived from that business or activity, had all commercial and financial transactions and relations been wholly at arm's length.

Section 90 is a general anti-avoidance provision used to counteract any transactions that were entered into or carried out for the sole or dominant purpose to obtain a tax benefit.

The Director-General can disregard the transaction or can assess in such other manner as the Director-General considers appropriate in order to counteract the tax benefit which would otherwise be obtained.

Guidance from Tax Authorities

Taxpayers are required to demonstrate their compliance with the Arm's Length Test included in Sections 75 and 90 of the MITA.

However, no specific guidance on transfer pricing has been issued by the Mauritius Revenue Authority (MRA).

The MRA has indicated in published tax rulings (TR31) that the computation of chargeable income varies from one country to another depending on the level of activities and financial risk undertaken by the entities concerned.

As such, for taxpayers with significant and complex related party transactions, they may be expected to undertake a Risk and Function Analysis in order to determine the appropriate method for transfer pricing, which must be in accordance to the arm's length principle.

"Taxpayers are required to demonstrate their compliance with the Arm's Length Test …"

Documentation Requirements

No specific 'Transfer Pricing Documentation' has been prescribed. It is up to the taxpayer to prove that the transaction is at arm's length.

Disclosure in Tax Return

Taxpayers are required to disclose in Form 3 (Mauritius Income Tax Return) whether the taxpayer had any related party transactions and whether the transactions were based on arm's length prices.

Deadline for Documentation

There is no deadline for preparation or submission of transfer pricing documentation.

However, taxpayer would be required to demonstrate that their transactions are at arm's length, upon request by the MRA.

"Taxpayers are required to disclose in Form 3 whether the taxpayer had any related party transactions and whether the transactions were based on arm's length prices.

MAURITIUS

(Continued)

Enforcement by Tax Authorities

Transfer pricing issues come up when tax returns are being examined. Usually transfer pricing issues come up mostly at customs duty level.

There has been an increased interest from the MRA in transactions between related parties and whether these transactions are at arm's length.

For underpayment of tax, the Director-General may impose additional tax of up to 50% of the tax undercharged under S129(1A) MITA.

Interest may also be charged for late payment of tax at 1% per month of the unpaid tax under S122D MITA.

Agreements with other Jurisdictions on Tax Disputes

"The Mauritian government has signed 34 tax treaties … with foreign jurisdictions …"

The Mauritian government has signed 34 tax treaties which cover exchange of information and resolution of disputes with foreign jurisdictions in respect of income tax and customs duty.

Taxpayers may invoke the Mutual Agreement Procedures (MAP) in these treaties to eliminate the double taxation that arises from transfer pricing adjustments made by one or both of the contracting states.

For enquiries on this article, please contact:

Mr Jaye Jingree
jjingree@krossborder.intnet.mu

SINGAPORE

STEVEN TAN RUSSELL BEDFORD PAC
Public Accounting Corporation

Transfer Pricing Legislation

Singapore does not have any detailed legislations on Transfer Pricing. Transfer pricing is governed by the existing provisions in the Income Tax Act (SITA), namely Sections 33 and 53(2A) of the SITA.

Section 33 is a general anti-avoidance provision used to counteract any arrangement that has the direct or indirect effect of reducing or delaying the tax liability of the taxpayer. The Comptroller can disregard the transaction or make adjustment as he thinks appropriate in order to counteract any tax advantage obtained or obtainable from or under that arrangement.

Section 53(2A) empowers the Comptroller to assess a non-resident to tax, if the business between the non-resident and a closely-connected resident was arranged in such a way that produces to the resident either no profits or less than the ordinary profits which might be expected to arise from that business.

As part of the Income Tax (Amendment) Bill 2009, a new section would be introduced which would specifically enact the arm's length principle into the SITA.

Guidance from Tax Authorities

The Inland Revenue Authority of Singapore (IRAS) issued a detailed set of Transfer Pricing Guidelines (TP Guidelines) on 23 February 2006. The IRAS also issued "Transfer Pricing Guidelines for Related Party Loans and Related Party Services" on 23 February 2009.

The TP Guidelines explains the arm's length principle, its application and the recommended preparation and maintenance of documentation to demonstrate compliance with the arms-length principle.

The guideline explains the reasons for adopting the arm's-length principle and suggested 5 methods namely

Traditional Transactional Methods

- Comparable uncontrolled price (CUP) method
- Resale price method
- Cost plus method

Transactional Profit Methods

- Profit split method
- Transactional net margin method ("TNMM")

In practice, as the reliability of the results produced by any method would be crucially affected by the availability and quality of data as well as the accuracy with which adjustments to achieve comparability can be made, the 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 chosen.

A taxpayer can select any one of the 5 methods, or even a modified version of a method listed above to comply with the arm's length principle, as long as the taxpayer maintains and is prepared to provide sufficient documentation to demonstrate that its transfer prices are established in accordance with the arm's length principle.

"… the IRAS does not have a specific preference for any one method."

Documentation Requirements

There is no specific provision in the SITA requiring taxpayers to prepare transfer pricing documentation.

However, as explained in the TP Guidelines, preparing & maintaining documentations would place the taxpayer in a position where it can readily demonstrate that it has exerted reasonable efforts to ensure that its transfer prices are consistent with the arm's length principle.

Therefore, adequate documentation will facilitate reviews by tax authorities on taxpayer's transfer pricing analyses and hence assist in resolving any transfer pricing issues that may arise.

Continue on page 16

SINGAPORE

(Continued)

Documentation Requirements (Continued)

Continued from page 15

The IRAS is conscious that keeping adequate documentation may result in compliance and administrative costs for taxpayers. As such, it adopted the following principles with regard to documentation:

"Taxpayers are only required to prepare or obtain documents necessary to allow a reasonable assessment of whether they have complied with the arm's length principle"

Taxpayers are only required to prepare or obtain documents necessary to allow a reasonable assessment of whether they have complied with the arm's length principle.

Taxpayers should evaluate the substantiality and complexity of the related party transactions as well as the costs of compliance arising from documentation.

As such, all taxpayers should perform and document a transfer pricing risk assessment regarding their related party transactions. Based on the assessment, the taxpayer should determine whether more detailed documentation is required.

The IRAS has listed in the TP Guidelines the types of information (not exhaustive) that may be helpful in substantiating that the taxpayer's transfer pricing analyses are in accordance with the arm's length principle and that the taxpayer has made reasonable efforts to determine arm's length transfer prices, margins or allocations.

Disclosure in Tax Return

No specific disclosure is required in Form C (Singapore Income Tax Return) on whether Transfer Pricing Documentation has been prepared or the methods used to determine transfer pricing levels.

However, they are required to disclose the above details if they receive a Questionnaire from the IRAS as part of its "Transfer Pricing Consultation" initiated in 2008-09.

Deadline for Documentation

There is no official deadline for the preparation of transfer pricing documentation. However, as explained in the TP Guidelines, adequate documentation, which should be prepared in a timely manner, would put the taxpayer in a better stead to defend its transfer pricing analysis and prevent transfer pricing adjustments arising from tax examinations by tax authorities.

There is also no deadline for submission of transfer pricing documentation. However, they should be available upon request by the IRAS (refer to Transfer Pricing Consultation below).

Enforcement by Tax Authorities

In the event that the company's pricing deviates significantly from the Comptroller's opinion of arm's length pricing, the Comptroller will express its position and make arrangements with the company to review the issue at an appropriate time.

The Comptroller may make the necessary adjustments to the taxable profits of the related parties in their jurisdictions so as to reflect the true value that would otherwise be derived on an arm's length basis.

Transfer Pricing Consultation

The IRAS issued a circular on "Transfer Pricing Consultation" on 30 July 2008 in which it indicated that it will carry out Transfer Pricing Consultation with selected taxpayers. Through this consultative process, IRAS will assess taxpayers' transfer pricing risks, review their transfer pricing documentation and provide recommendations for managing risks.

The IRAS will send questionnaires to selected taxpayers who have or appear to have significant amount of related party transactions, especially with overseas parties.

Based on the response to the questionnaire, which include the extent of documentation prepared in comparison to the TP Guidelines, the IRAS will assess if a Transfer Pricing Consultation should be undertaken for the taxpayer.

Continue on page 17

Enforcement by Tax Authorities (Continued)

SINGAPORE

(Continued)

Continued from page 16

The Transfer Pricing Consultation entails a field visit to companies to better understand the company's business and physical review of documentation if necessary. The IRAS officers will assess the level of compliance with the transfer pricing guidelines and identify potential areas where IRAS can further facilitate and advise taxpayers on good practices in transfer pricing.

The IRAS has increased awareness of transfer pricing issues by issuing the TP Guidelines in 2006. The Transfer Pricing Consultation has the effect of both educating and monitoring taxpayers on the application of the arm's length principle as well as the documentation requirements. As such, there is a greater likelihood for more tax audits involving transfer pricing.

There are no specific penalties for transfer pricing offences provided in the SITA. It is likely that the general provisions would be invoked by the IRAS relating to understatement of income. Penalties of up to two times the tax undercharged may be imposed. In cases of fraud, penalties will be up to three times the amount of tax undercharged. For Serious cases of errors may face prosecution.

"Transfer Pricing Consultation has the effect of both educating and monitoring taxpayers …"

Agreements with other Jurisdictions on Tax Disputes

Singapore currently has a network of at least 50 comprehensive Double Taxation Agreements ("DTAs") in force. All these DTAs provide for the Mutual Agreement Procedure ("MAP") to resolve instances of double taxation.

Taxpayers may apply to the competent authorities (of the jurisdiction of which they are residents) to invoke the MAP, in order to eliminate the double taxation that arises from the transfer pricing adjustments made.

In recognition of commercial needs for certainty, the IRAS has made available the Advance Pricing Arrangement ("APA") facility to taxpayers who are engaged in cross-border related party transactions.

Guidance is provided in the TP Guidelines as well as in the circular "Supplementary Administrative Guidance on Advance Pricing Arrangements" issued by the IRAS on 20 October 2008.

For bilateral and multilateral APAs, there must be a double tax agreement between Singapore and the other countries involved.

However, the IRAS have emphasised that taxpayers should ensure they have sufficient resource to support the APA application.

The IRAS may consider request to roll back bilateral or multilateral APAs to prior years based on the merits of the request, provided that there have been no significant changes to facts and circumstances during the "roll-back" period such that the transfer pricing methodology remains relevant to those earlier periods.

Generally, an acceptable "roll-back" period should not exceed 2 years prior to the proposed APA covered period.

For enquiries on this article, please contact:

Ms Soo Geok Keen
sgk@stcsamasmgt.com.sg

"Singapore currently has a network of at least 50 comprehensive DTAs in force."

SOUTH KOREA

CJAC 천지회계법인 CHEON JI ACCOUNTING CORPORATION

Transfer Pricing Legislation

The Law for the Coordination of International Tax Affairs (LCITA) authorises the tax authorities to adjust the transfer price based on an arm's length price (ALP) and to determine or recalculate a resident's taxable income when the transfer price of a Korean company and its foreign counterpart is either below or above an ALP.

Guidance from Tax Authorities

The Presidential Enforcement Decree of the LCITA states that an ALP should be determined by the most reasonable method applicable to the situation, whether it be the comparable uncontrolled price (CUP) method, the resale price method, the cost plus method, or any other method.

"… the traditional transaction methods … have priority over transactional profit methods …"

The Decree sets out the following criteria for selecting the most reasonable method.

- The level of comparability between the transactions of related parties and those of independent parties must be high.
- Sufficient data on a comparable independent party must exist.
- The economic assumptions made in comparing the related parties' transactions with those of independent parties must reflect the actual economic situation of the parties.

The degree of comparability can be evaluated on the following factors:

- Functions performed and risks assumed, as reflected in conditions and transactions;
- Types as well as characteristics of the goods or services involved; and
- Economic environment of the market and the degree of change in market conditions.

Priority of Methods

If there is a transaction between unrelated parties that is identical or similar to the transactions between the related parties at issue, the CUP method will be selected over any other method.

Among the methods of determining an ALP, traditional transaction methods such as the CUP method, the resale price method, and the cost-plus method, have priority over transactional profit methods such as the profit split method, the transactional net margin method, or the Berry Ratio method, which are intended to be used only if the traditional methods are inapplicable.

For example, the Berry Ratio method may be applicable in cases where the Korean company carries out simple sales activities or renders service without carrying any burden of inventory.

Transactions suspected to be manipulated and not a ALP cannot be used as a comparable. The tax authorities may use an ALP range determined by two or more uncontrolled transactions to adjust the taxable income of taxpayers. Such tax adjustment must be made based upon reasonable values computed from the transactions examined.

Documentation Requirements

The transfer pricing method used and the reason for adopting that particular one for an ALP determination must be disclosed to the tax authorities by a taxpayer in a report submitted along with the annual tax return.

Continue on page 19

Documentation Requirements (Continued)

SOUTH KOREA

(Continued)

Continued from page 18

Taxpayers are also required to submit the following:

- Summary of international transactions
- Summary of income statements of overseas affiliates
- Report of ALP calculation method (intangible assets, services and others)

Exemption

Exemption is granted if the total value of international transactions of goods and that of international transactions of services of the taxpayer for the taxable year concerned is 5 billion won or less and 500 million won or less, respectively.

An exemption is also granted if during the tax year, the transactions of goods with each overseas affiliate amount to 1 billion won or less and the transactions in services amount to 100million won or less.

Request for Transfer Pricing Documents

Previously, taxpayers have 60 days (with a further 60 day extension) to submit the transfer pricing documentations.

However, according to the amendment to the Decree, the underreporting penalty (10% of the additional corporate tax if not intentional) is waived if the taxpayer submits the documentation within 30 days.

The waiver applies to those companies who properly prepares and maintains contemporaneous transfer pricing documentations and has transfer pricing methods recognised as reasonably selected and applied.

Request for Other Documents

The tax authorities may also request the following from a taxpayer:

- a copy of the sales contract between the Korean company and its foreign counterpart
- a price list of the products at issue
- a schedule of the manufacturing cost of the products
- an organizational chart of the company with a description of the functions of each department
- the inter-company price policy
- the equity relationship of the group

During a tax audit, documents requested are expected to be promptly produced.

"… underreporting penalty … is waived if the taxpayer submits the documentation within 30 days."

Enforcement by Tax Authorities

The Korean National Tax Service (NTS) generally reviews the tax returns and transfer pricing documents to identify taxpayers that have a high likelihood of not trading at an ALP which may be selected for tax audits.

The NTS has aggressively challenged royalty payments and management service fees paid to overseas affiliates, especially those located in tax haven countries.

In addition, taxpayers are generally subject to a tax audit every five years due to the tax statute of limitation.

If a taxpayer refuses to provide transfer pricing documentations as requested, the NTS may refuse submission of the documentation at the time of appeal.

In addition, the taxpayer may be subject to a penalty of up to 30 million won for each instance of failing to submit information (without justifiable reason) or for providing false information.

Secondary Adjustments

In addition to the existing penalties for understatement of taxes, if the amount of transfer pricing adjustments are not repatriated back to Korea, it will also be subject to a secondary adjustment which generally treats the amount of the transfer pricing adjustment as a deemed dividend.

"… taxpayers are generally subject to a tax audit every five years … "

SOUTH KOREA

(Continued)

Agreements with other Jurisdictions on Tax Disputes

Advance Pricing Arrangement (APA) System

A taxpayer can obtain an APA for transactions with foreign related parties by submitting an application to the NTS prior to the tax year for which the APA is being sought.

Prior to the NTS' final approval, an applicant for an APA may withdraw or modify his application for an APA.

Once the NTS approves the application of a certain method for determining an ALP, the NTS is legally bound by the method agreed upon in the APA and cannot make adjustments if the taxpayer's transfer prices are within the agreed range.

"Once the NTS approves the application … the NTS is legally bound by the method agreed upon in the APA …"

It may be possible to roll back an APA to prior open tax years by filing an amended tax return that reflects the change from its prior inter-company price with a related party and the price determined under the APA.

Any data submitted with the application for an APA will be used to only determine whether or not to grant an APA. If an application for an APA is refused or withdrawn, such data will be returned to the applicant in order to safeguard the confidentiality right of the taxpayer.

In case where an APA is obtained, a taxpayer is required to file an annual report which shows the inter-company price which was determined by the method agreed upon under the APA within six months of the annual tax return submission due date.

A taxpayer who applies for a Bilateral APA may request that the NTS invoke a Mutual Agreement Procedure (MAP) with the competent authorities of the country in which its related foreign party is a resident under the relevant tax treaty.

However, the NTS may grant an APA without undergoing a MAP for the taxpayer's convenience.

Corresponding Adjustment

The LCITA and its Enforcement Decree state that if a foreign government, on the basis of an ALP, increases the taxable income of a foreign company which is an associated enterprise to its Korean counterpart, the Korean government will correspondingly reduce the taxable income of that Korean company if the two governments have agreed upon an ALP applicable to the case through a MAP. In such a case, a taxpayer may apply for a downward adjustment in his taxable income by filing a notification of the MAP results with the tax authorities.

Adjustment with regard to a Cost Sharing Agreement (CSA)

International standards used to verify appropriateness of cost sharing between a resident and its foreign related party have been reflected in domestic tax law.

For enquiries on this article, please contact:

Mr Brian Shim
yss@cjac.net

Disclaimer

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

Business consultants with a global perspective

Russell Bedford Asia Pacific Offices Contacts

Australia

Brisbane
Rod Allan
rallan@hogglawson.com.au
www.hogglawson.com.au

Melbourne
Bruce Saward
bruce@sawarddawson.com.au
www.youraccountant.com.au

Perth
John Van Dieren
jvdieren@stantons.com.au
www.stantons.com.au

Sydney
Greg Ralph
gralph@gouldralph.com.au
www.gouldralph.com.au

China

Beijing / Shanghai
Guoqi Wang
guoqi_wang@huaander.com
www.huaander.com

Hong Kong / Guangzhou / Shanghai
Ian Lee
ianlee@russellbedford.com.hk
www.russellbedford.com.hk

India
Shreedhar T. Kunte
sharp@bom3.vsnl.net.in
www.sharp-tannan.com

Indonesia
Syarief Basir
sbasir@russellbedford.co.id
www.russellbedford.co.id

Korea (South)
Brian Shim
yss@cjac.net
www.cjac.net

Malaysia
Loh Kok Leong
lohkl@russellbedford.com.my
www.russellbedford.com.my

Mauritius
Jaye C. Jingree
jjingree@krossborder.intnet.mu
www.krossborder.com

Pakistan
Rashid Rahman Mir
rsrirlhr@brain.net.pk

Singapore
Douglas Tan
douglas@stcsamasmgt.com.sg

Russell Bedford International
Russell Bedford House
250 City Road
London EC1V 2QQ
United Kingdom

marketing@russellbedford.com

www.russellbedford.com

Russell Bedford International is a global network of independent accountancy firms providing audit, assurance, tax and business advisory services.

Ranked as one of the world's top 15 accounting networks*, Russell Bedford International is represented by some 460 partners, 5,000 staff and 200 offices in more than 70 countries in Europe, the Americas, Middle East, Africa, Indian Sub-Continent and Asia-Pacific.

*Ranked by global revenues in International Accounting Bulletin World Surveys. Networks defined in accordance with IFAC Code of Ethics.