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Southeast Asia

Transfer Pricing updates

October 2017

Transfer Pricing newsletter

Southeast Asia Transfer Pricing Center

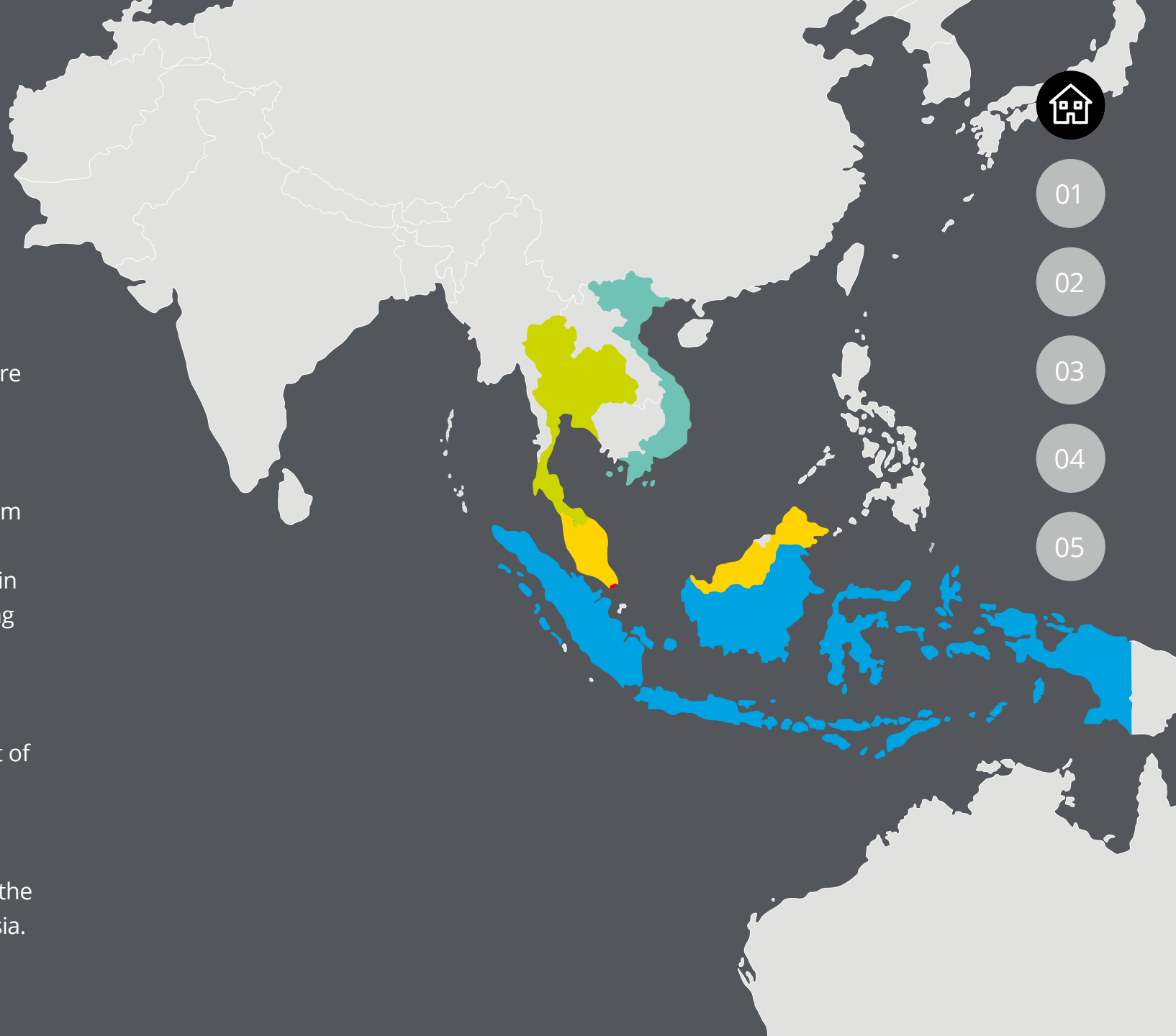
Introduction

The legal landscape within Southeast Asia is constantly evolving, with regulatory structures and compliance requirements continuously changing. This is no more apparent than in transfer pricing, where tax authorities are currently drafting regulations to comply with new global standards.

As these changes give shape to a more transparent system and globally consistent regulations, taxpayers face increasing exposure to transfer pricing risks, particularly in the areas of compliance requirements and transfer pricing audits.

These risks can be mitigated by taking a proactive stance towards transfer pricing, wherein taxpayers keep abreast of changing regulations and are therefore able to address potential issues before they become a problem.

To help you do that, we have compiled in this newsletter the pertinent regulatory changes to date within Southeast Asia.



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Singapore



There have been two key developments in Singapore, both of which have far-reaching implications for taxpayers from a transfer pricing perspective.

The first is the signing of the **Multilateral Competent Authority Agreement on the exchange of Country-by-Country Reports** (MCAA CbCR) on 21 June 2017. This circumvents the need for tax administrators to negotiate and conclude multiple bilateral agreements with other tax authorities, as the agreement provides a strong framework for ensuring that different countries will exchange information on CbCR.

This is a strong push towards openness of information sharing among tax authorities, thereby facilitating the process in the event of an international transfer pricing audit.



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Singapore

As of August 2017, there have been 95 signatories to this agreement, including:



Australia



Indonesia



Korea



China



Japan



Malaysia

It must be noted, however, that Singapore signing the agreement does not imply an automatic exchange of information (AEOI) with the other signatories; signatories will only exchange CbCR on a bilateral basis if both parties agree. Singapore will establish bilateral AEOI relationship with signatories that can meet the following principles:

- AEOI partner has safeguards needed to ensure the confidentiality of information exchanged and prevent its unauthorized use; and

- There is full reciprocity with the AEOI partner in terms of information exchanged.

The second development pertains to the draft **Income Tax (Amendment) Bill 2017**, which was circulated to the public for consultation from 19 June 2017 to 10 July 2017. The impact of this bill from a transfer pricing perspective are as follows:

- **The introduction of a minimum revenue requirement for transfer pricing documentation (TPD)** – Under the draft regulations, only companies with more than S\$10 million must prepare transfer pricing documentations, with the aim of reducing the compliance burden on taxpayers. This is an additional safe-harbor to the existing thresholds. The requirements to prepare the TPD before the filing deadline of tax return and to submit it within 30 days from request are also in the draft regulation. Documentation must now be retained for at least five years. Violations of these new

requirements, including submission of false or misleading TPDs, may result in a S\$10,000 fine.

- **Clarification regarding the implementation of the arm's length principle** – The Inland Revenue Authority of Singapore (IRAS) now has the power to look at the actual substance of a transaction, rather than just the written form when testing for the arm's length principle. As such, it may disregard formal relationships when it is established that third parties will not enter into similar transactions.
- **Introduction of a surcharge on adjustments** – According to the proposed changes, any adjustments made by the IRAS will be subject to a 5% surcharge, except "for any good cause."



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Singapore

- **Lifting of time bar for MAP cases** – Under the draft bill, Singapore waives the four-year time bar for the IRAS to raise any additional adjustments for cases under MAP process. As such, taxpayers can be assured that any outcome of a MAP proceeding will be given full effect. However, this increases the need for a favorable MAP ruling.
- **Requirement of TPD for any error** – The proposed changes stipulate that any claim for error made in the tax return must be supported by an adequate TPD.



Vietnam



Vietnam's Ministry of Finance (MoF) released guidelines on Decree 20, which is the foundation of all transfer pricing regulations within the country. Specifically, Circular 41 provides guidelines on **Articles 6, 7, 10, and 11 of Decree 20**, as well as three appendices to these guidelines, which cover (1) the formula for the interquartile range, (2) detailed guidance relating to Form 1, and (3) detailed guidance relating to Form 4.

This is part of Vietnam's increased documentation requirements as it works towards unifying its regulations.



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Vietnam

The salient points of the guidelines are:

- **Emphasis of substance over form** – The MoF has a renewed drive towards the analysis of the actual substance of transactions rather than forms. The regulation empowers tax authorities to make adjustments if the transaction is not similar to “business decisions” made between third parties.
- **Enumeration of the criteria for the selection of comparables** – The MoF has stipulated that the following specific conditions must be assessed in the selection of comparables:
 - Characteristics of the product/service
 - Functions performed, assets held, and risks taken
 - Contractual terms
 - Economic conditions

By enumerating these factors, the MoF has defined the specific criteria that will be assessed during an audit; this limits the taxpayers’ exposure, but it increases the need for sufficient TPD.

- **Burden of adjustments** – Taxpayers must make transfer pricing adjustments if their prices, profit level indicator or profit allocation rating fall out of the arm’s length range based on the “most comparable arm’s length value” and without decreasing tax liabilities. It also specifies that any adjustments made by the tax authorities will always be to the median of the interquartile range. This should encourage taxpayers to be proactive in managing transfer pricing risks, as potential adjustments made by the MoF will be significantly more burdensome.

- **Required forms** – The MoF has laid down regulations regarding the forms it will require from a transfer pricing perspective. In line with Action 13 of the OECD, Vietnam now requires the submission of the Local File (LF), the Master File (MF), and the CbCR. As such, it will require the following forms:
 - Form 1: List of related party transactions and information relating to the actual transaction and the counterparty
 - Form 2: List of information to be provided in the LF
 - Form 3: List of information to be provided in the MF
 - Form 4: List of information to be provided in the CbCR



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Vietnam

These forms need to be attached with the corporate income tax return filed within 90 days from the end of the financial year or within 30 days in all other cases. The transfer pricing documentation consisting of MF, LF, and CbCR, must be submitted within 15 days from date of request during an audit, or within 30 days during consultation period.

In addition to this, the MoF included changes in the **Transfer Pricing Declaration Form**, which are as follows:

- **Valuation of Assets** – the MoF now prescribes that the declared value of fixed assets and tangible products in Form 1 must be based on purchase price.
- **Enumeration of acceptable transfer pricing methods** – It allows the use of internal and external CUP, RPM, CPM, TNMM, and the profit split method. No other method will be allowed. It also states its preference for CUP for products listed on domestic and international markets.
- **Calculation of operating margin for purposes of determining exemption to prepare TPD** – Circular 41 provides guidelines on how to calculate the operating margin for purposes of determining exemption to prepare TPD.



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Thailand



In Thailand, there have been two main developments from a transfer pricing perspective: (1) The release of the draft version of **Thai transfer pricing regulations**, and (2) Thailand's commitment to adopt **Action 13 of the OECD's Base Erosion and Profit Shifting (BEPS) framework** by joining the inclusive framework for the global implementation of the BEPS project as an associate member. These developments solidify the Thai Revenue Department's (TRD) commitment to align its transfer pricing system with its regional and global peers.



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Thailand

With the TRD's release of the draft version of Thai transfer pricing regulations, it has clarified transfer pricing guidelines, thereby placing clear boundaries on the exposure of taxpayers to transfer pricing.

- **Power of the TRD to make TP adjustments**

The TRD is empowered to re-assess taxable income and expenses based on the application of the arm's length principle and to eliminate double taxation arising from its re-assessment.

The regulation also extends the powers of the TRD: It can evaluate the nature of related party transactions and assess whether it complies with the arm's length principle. It can also enact adjustments designed to eliminate double taxation. This allows taxpayers to file for tax refunds, provided that the refund is filed within three years from the deadline of the pertinent tax return, or within 60 days from the receipt of a notification letter from the TRD.

A Thai party may claim refund within three years from due date of filing of income tax return or within 60 to 120 days after the date of receipt of a notification letter from the TRD.

- **Definition of 'Related Parties'**

The draft regulations define 'related parties' based on an ownership threshold of 50%, or based on shareholding, management or control relationship where the other party is not able to act independently from the other party.

- **Requirement to submit a 'report'**

As such, taxpayers with related party transactions are now required to submit a 'report' in a prescribed format, provided that it meets a certain revenue threshold. The revenue threshold is with reference to the related party transaction. This report must be submitted with the annual tax return.

Within five years from the filing of the report, the TRD has the power to request additional documentation or evidence and failure to provide such documentation within 60 days of the Director-General's request may result in a fine of up to THB200,000.

- **Thailand joins inclusive framework for the implementation of BEPS**

The second development is Thailand's decision to join the inclusive framework for the global implementation of BEPS. As an associate country, Thailand can work with G20 and OECD members on developing standards on BEPS-related issues and monitoring of BEPS implementation package.



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Indonesia



As the first mover in implementing Action 13 in Southeast Asia, Indonesia saw the initial implementation of PMK 213, when most companies filed their tax returns in April 2017. A look at the experiences of taxpayers in trying to comply revealed some issues, such as:

- **Early requirement for MF** – The new regulation poses challenges for MNCs as there could be timing differences in terms of the deadline for preparing MFs in their home country vis-a-vis Indonesia. The local subsidiaries of MNCs have to ensure that the bare minimum information as stipulated in the new regulation is contained in the MF for local compliance purposes (prepared either through their headquarters or on their own).



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Indonesia

- **Disclosure of details regarding the Board of Management** – A requirement of the MF, compliance has been a challenge since this would involve a large amount of data. Data provided usually pertains only to top-level management.
- **Contracts regarding intangible assets** – Intangible asset contracts, such as cost contribution agreements, R&D contracts, and licensing agreements, have been challenging as many companies have not formalized these transactions.
- **Contracts on intercompany transactions** – The LF requires that tangible goods transactions have a formalized intercompany contract, which stipulates the standard terms of trade between related parties. Again, many companies have not formalized these transactions with a contract.
- **Pricing policy** – The LF requires that all intercompany transactions have a formalized pricing policy that must be adhered to; many companies are unable to produce such policies. In cases where pricing policies are present, these policies are often not strictly observed.
- **Explanation and background third party dealings** – Confidentiality of terms becomes a contentious issue, as disclosure of such information may compromise competitive advantages.
- **Functional segmentation** – Functional segmentation may put a company at risk as third party margins are generally higher (albeit due to the difference in FAR profile).

Indonesia signs the MCAA CbCR

Indonesia is a signatory to the MCAA CbCR, and PMK 39 stipulates that it will engage in the automatic exchange of information. However, it will only exchange:

- the allocation of income, tax paid, business activity per country/jurisdiction from all group members (domestic and overseas); and
- the list of business group members and main activity per country/jurisdiction.



Malaysia



Malaysia's Inland Revenue Board (IRB) **released revisions to the Malaysian Transfer Pricing Guidelines 2012 (TPG)** to align with BEPS Actions 8-10 and Action 13 recommendations. The salient features of the revised guidelines are as follows:

- **Chapter 2: The Arm's Length Principle** – The IRB reaffirms that the arm's length principle will be adopted. Importance is placed upon conduct over contract in realizing an outcome that is consistent with value creation and on the accurate delineation of transactions. In this regard, the following principles have been adopted:
 - Risk-free return for capital provision that lacks functionality
 - Correlation of functional analysis with value-creation (group-wide)
 - Disregarding transactions that are not commercially rational



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Malaysia

- The form of remuneration is not sufficient to dictate assumption/allocation of risk between affiliates

- **Chapter 8: Intangibles** – IRB defines “intangibles” consistent with OECD guidelines. Thus, the new chapter recognizes the following as intangibles:
 - Government licenses and contractual rights in certain conditions
 - Exclusive rights over intangibles

The revised guidance also recognizes the DEMPE concept, the legal ownership of intangibles, and the concept of Hard-to-Value Intangibles in connection with entitlement to differentiate between ex-ante and ex-post return.

IRB laid down the minimum documentation that would be required from the taxpayer in relation to royalties being paid. IRB would

disallow royalty payment if it cannot be demonstrated that the payments are for newly developed or enhanced intangibles.

Furthermore, the revised guideline detailed the economically significant activities in connection with intangibles and stated that such activities should earn more than a routine low cost plus remuneration. The activities identified as core functions are as follows:

- Research and development activities that lead to customization/enhancement of existing products or new products
- Activities that lead to improvement in manufacturing process
- Advertising, marketing, and promotional activities that lead to creation/enhancement of marketing intangibles
- Managing customer relationship, localization of products/advertisements or marketing survey, including collection of local data

- **Chapter 10: Commodity Transactions** – The CUP method has been determined to be the preferred method for assessing commodity transactions, and taxpayers are required to provide evidence of a price-setting policy as part of transfer pricing documentation. The terms “commodity” and “quoted price” have been defined by the IRB as follows:
 - Commodity – Physical products for which a quoted price is used as a reference by independent parties in the industry to set prices in uncontrolled transactions
 - Quoted price – Price of the commodity in the relevant period obtained in a domestic or international commodity exchange market

Where there is dispute regarding the pricing date, the date will be determined upon the IRB’s discretion.



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Malaysia

- **Chapter 11: Documentation** – The IRB reaffirms the requirement to prepare contemporaneous transfer pricing documentation (TPD). The revised guideline defined what may be considered material changes in operational and/or economic conditions warranting update of TPD.
 - Examples of material operational changes include:
 - Changes in the shareholding
 - Changes in business activities and business model
 - Changes in financing structure
 - Changes in transfer pricing policies
 - Mergers and/or acquisitions
 - Examples of material economic changes include:
 - Economic downturns
 - Foreign exchange fluctuations
 - Natural disasters

Furthermore, the IRB stated that, provided there are no changes in the operational conditions, comparables search needs to be refreshed every three years. However, the suitability of these companies must be assessed on an annual basis. The IRB also requires additional items to be contained in the TPD. Furthermore, the filing of MF is now required for all companies required to file a CbCr with such MF to be submitted along with the TPD.

Note that inaccurate selection of comparables can be ground for levy of penalty.

- **Sample notification letter** – The IRB has issued two different sample notification letters for entities subject to the CbCr notification requirements -- one for reporting entities and the other for non-reporting

entities. To avoid duplication, notification may be provided by one Malaysian constituent entity on behalf of other Malaysian constituent entities of the same MNE group.

If the CbCr threshold is met, an immediate next step is to provide the director general of the IRB with a written notification listing the reporting entity of the MNE group on or before the last day of the reporting financial year.

Failure to notify the director general within the required time frame may incur a penalty for non-compliance with the CbCr rules.



About the Deloitte SEA Transfer Pricing Center

The Deloitte Southeast Asia Transfer Pricing Center (SEA TPC) was established in Manila to spearhead and coordinate regional TP projects in SEA. In a post-BEPS world, increased demands for transparency and compliance have made transfer pricing risks more prevalent than ever.

Deloitte's holistic approach to transfer pricing focuses on the unique needs of your business. We provide a clear perspective to guide you through uncertainty in the global tax environment, and we help you mitigate risk by taking a proactive stance towards potential issues, and developing robust, pragmatic transfer pricing policies and globally consistent documentation processes.

With a full range of TP services, the SEA TPC capitalizes on its experience and expertise to develop solutions that are custom-tailored to your needs. We help you navigate highly complex international regulations to mitigate transfer pricing risks and ensure that your operations remain highly efficient.

Partnering with the SEA TPC will give you unrivalled access to Deloitte's approach, tools, and expertise from around the region, yielding an unparalleled level of consistency, cost-efficiency, and speed. We will partner with you every step of the way—advising you of potential liabilities before they become issues, and alerting you to inconsistencies across your operations.

With the SEA TPC, you can rest assured that operations are streamlined from a transfer pricing perspective, allowing you to focus on your business rather than worry about potential government liabilities.

Clarity. Consistency. Confidence. That's how Deloitte empowers you to renew your global approach to transfer pricing.



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Contact us

Transfer Pricing Leaders in Deloitte Southeast Asia

Carlo L. Navarro
Deloitte Southeast Asia
Transfer Pricing Leader
canavarro@deloitte.com

Brunei
Pengiran Maksin
pmaksin@deloitte.com

See Jee Chang
jcsee@deloitte.com

Cambodia
Kimsroy Chhiv
kchhiv@deloitte.com

Guam
Jennie Chiu
jenchiu@deloitte.com

Indonesia
Roy David Kiantong
rkiantong@deloitte.com

Lao PDR
Anthony Visate Loh
aloh@deloitte.com

Malaysia
Theresa Goh
tgoh@deloitte.com

Myanmar
Aye Cho
aycho@deloitte.com

Singapore
See Jee Chang
jcsee@deloitte.com

Thailand
Stuart Simons
ssimons@deloitte.com

Vietnam
Thomas McClelland
tmcclelland@deloitte.com





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