NUS National University of Singapore

Source: *The Sunday Times*, pB14
Date: 16 July 2017

FinancialQuotient

What is transfer pricing?

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WHAT DOES IT MEAN?

The term "transfer pricing" often crops up when companies trade with related companies within a group structure, and have to decide on the prices of their transactions. For example, when a Singapore parent company sells to its overseas subsidiary, it has to decide on the transfer price for the transaction.

In practice, transfer pricing not only applies to the purchase and sale of goods, but also extends to the provision of services and the sale of intangible properties such as patents and trademarks.

WHY IS IT IMPORTANT?

If companies are at liberty to fix their transfer pricing, then the entity selling the goods, services or intangible properties might be motivated to charge a higher transfer price when it is located in a low-tax country when compared with the related buyer who is located in a high-tax country. This way, tax savings could be achieved at the group level, based on the differential tax rates of the two countries.

However, such practices are unlikely to go unnoticed and are likely to be subject to challenge by the tax authorities worldwide, most of which have detailed transfer pricing laws and guidelines to check any arbitrary transfer pricing not substantiated by an arm's length principle.

Companies with substantial inter-company transactions, particularly those involving cross-border transactions, need to comply with such laws and guidelines.

IF YOU WANT TO USE THE TERM, JUST SAY:

"This country has developed transfer pricing guidelines to regulate the prices charged for the sale of goods and services between related companies."

• The writer is Associate Professor (Practice) of the Department of Accounting at NUS Business School. The opinions expressed are those of the writer and do not represent the views and opinions of NUS.

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