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IRAS e-Tax Guide

Transfer Pricing Guidelines
Special Topic –
Centralised Activities in
Multinational Enterprise Groups
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Table of Contents

	Page
1 Aim	1
2 At a glance	1
3 Glossary	2
4 Headquarters	3
5. Why MNE groups centralise activities.....	4
6. Headquarters in Singapore.....	6
8 HQs in practice	18
9 Transfer pricing documentation requirements	19
10 Avoiding and resolving transfer pricing dispute	21
Annex A - Case study of a regional HQ	23

1 Aim

- 1.1 This e-Tax Guide:
 - i. Discusses the economic value contributions of centralised activities in Singapore and their importance to a multinational enterprise (“MNE”) group; and
 - ii. Explains how to analyse such activities carried out in Singapore between related parties, the factors that may affect the transfer price for these activities and the transfer pricing methods that may be appropriate.¹
- 1.2 This e-Tax Guide is relevant to you if you are a business entity (including branches) incorporated or registered in Singapore and have centralisation of activities within your MNE group.

2 At a glance

- 2.1 Singapore is home to a large number of headquarters (“HQs”), including those from the world’s leading companies. MNE groups looking to deepen their presence in Asia may leverage Singapore as a home to centralise key decision-making, management and coordination, build customer insights and develop product and services strategies for local markets. In turn, Singapore-based service providers have deepened capabilities and broadened their networks to support business, innovation and talent needs of HQs.
- 2.2 Within the context of MNE groups, there are many different transactions among the various members in the group. A thorough examination of the actual functions performed, assets used, and risks assumed in each specific related party transaction is important in determining the arm’s length transfer price.

¹ This e-Tax Guide should be read together with the IRAS e-Tax guide on Transfer Pricing Guidelines.

3 Glossary

3.1 Headquarters (“HQ”)

Centralised office location(s) where an MNE group’s management and key staff operate and oversee business activities.

3.2 Entrepreneur

Entity(ies) within an MNE group which:

- i. Performs significant functions to organise and operate the business;
- ii. Makes key business decisions; and
- iii. Controls and assumes significant risk and has the financial capacity to assume risk

3.3 Centralised services

Activities centralised in the parent company or one or more group service centres (such as a regional HQ) and made available to the group (or multiple members thereof).

4 Headquarters

- 4.1 The term “headquarters” is commonly used for tax, corporate planning and corporate communications purposes. It is also commonly used to describe entities in transfer pricing documentation. However, the use of the term alone is not indicative of the actual functions, assets and risks profile of the HQ. In practice, IRAS has encountered HQs with functional profiles ranging from a service provider to an entrepreneur.
- 4.2 In the same vein, the performance of centralised services alone does not mean that an entity should be considered a HQ within the MNE group, as there are other considerations such as the organisation structure and strategic importance of the activities performed, relative to other parts of the MNE group.
- 4.3 For the purposes of this e-Tax Guide, the label HQ does not dictate the transfer pricing analysis. The role of each HQ has to be considered on its own facts and circumstances.

5. Why MNE groups centralise activities²

- 5.1. Centralising activities, either globally or regionally, allows the MNE group to control, manage and consolidate business operations, processes and key functions. By doing so, the MNE group may achieve core benefits, which are listed as follows:

Directing overall business performance and aggregating specialised knowledge

- 5.2. For the specific functions, the most qualified personnel among the group's employees (or those within the region in the case of regional HQ activities) are brought together to perform the functions, make decisions or provide guidance to all business units under its charge. These personnel have effective oversight of the business units' operations and decide on the strategies and policies to be implemented across the relevant markets. They are accountable for the overall performance of the group globally or in a particular region.
- 5.3. Further, centralising subject matter experts in specialised HQ functions, such as Finance, Marketing, Human Resources, Legal and Intellectual Property (IP) management, aggregates domain expertise and talent. This allows the MNE group to deepen functional excellence and increase its competitive advantage.

Accelerating decision-making in response to market conditions

- 5.4. Centralising oversight of performance enables the group to be agile in its decision-making processes in that relevant information is available to centralised decision-makers so that they can collaborate, react and plan quickly to capture commercial opportunities and mitigate challenges. This is particularly important when the MNE group responds to changing market conditions, pilots new initiatives or transforms their existing business models and processes.

Achieving economies of scale and cost efficiencies

- 5.5. Entities within an MNE group often require common functions, such as Finance, Marketing, Human Resources, Legal, IP management, Sourcing and Procurement. Centralising these activities reduces duplication of functions, coordination costs, inefficiencies and operating costs.
- 5.6. The streamlining of certain activities can also reap significant economies of scale and value to the MNE group. Centralised procurement is one such example. Typically, the HQ performing this function would have access to information on market demands, orders, production schedules and excess

² Sections 5 and 6 are developed with the support of the Singapore Economic Development Board ("EDB").

capacity across business units. With the information, it could optimise the procurement of raw materials for the whole group or region by planning the timing and quantity to procure, or by diverting materials and inventories within the group. Bulk procurement may also offer the group greater bargaining powers to negotiate for lower prices, access to a wider range of supplies and faster delivery.

Driving consistency in branding, marketing and creative strategies and capturing real-time market opportunities

- 5.7 Where HQs oversee a region with diversity such as Asia, centralising branding and marketing (B&M) enables ease of development, launch and governance of regional marketing and sales strategies with a consistent brand identity, as compared to multiple differentiated in-market strategies which lead to dilution of corporate brand identity.
- 5.8 As MNE groups progress from classical marketing to digital marketing, centralising customer data and analytics enables regional executives and decision makers to capitalise on sales and marketing opportunities in real time, while evaluating market performance and competitor offerings. This allows marketing efforts to be more targeted and better meet consumer demand.
- 5.9 Centralising B&M also enables quicker feedback to R&D and product innovation teams, who will need to consider in-market nuances within their regional markets. This allows MNE groups to sharpen product innovation and design quickly for better market fit and sales results.

Proximity to markets

- 5.10 A management team that is located far away from the markets may have poor visibility of market conditions. Consequently, the team takes a longer time and is less agile to react to changes in consumer preferences and market developments. This results in possible loss of commercial value. With the pressure of competition in the globalised economy, it becomes increasingly important for MNE groups to meet market demands in a timely manner.
- 5.11 A HQ, particularly a regional HQ, allows the management team to be located closer to the markets where it can have real-time access to market intelligence, react faster to changes in market conditions, make speedier decisions, and have better control over the business' performance, including resource allocation to priority markets.

6. Headquarters in Singapore

- 6.1 While companies' global HQs are usually based where they were founded, companies may have a variety of considerations in choosing locations to build up other HQs. One company may choose to locate its regional HQs close to its key manufacturing sites. Another could prioritise proximity to growth markets and key clients. Others prefer a location offering access to innovative ecosystems. Overall, many often prize highly connected global cities that provide unparalleled access to highly specialised services, financing, talent and increasingly data security and related capabilities.
- 6.2 Singapore is often a preferred location for setting up HQs due to the presence of key attributes that are essential for HQ activities. Singapore ranks amongst the top in the world in terms of a competitive economy and ease of doing business. In addition, Singapore's strategic location in the geographical heart of Asia, vibrant innovation ecosystem, strong talent base and established infrastructure present a unique combination of factors that allow a Singapore-based HQ to host a range of business activities.

Business capital of Asia

- 6.3 Singapore is strategically located in the heart of Asia. With an established and extensive network of air and shipping routes and carriers, Singapore is an excellent location for MNE groups to site critical functions and key decision makers, and gain access to the expanding Asian markets.
- 6.4 As Asia becomes an increasingly important market as well as production base, some MNE groups are choosing to site global and not just regional HQ functions in Singapore.

Sophisticated ecosystem

Supply chain management capabilities

- 6.5 The need to optimise and manage supply chains against the rapidly changing supply and demand markets is increasingly complex and performance-critical. Global companies have established a sophisticated footprint of operations and suppliers across Asia. In this respect, the Asian geography is very diverse, with little standardisation of regulations, business practices and infrastructure development.
- 6.6 Singapore is an ideal location for MNE groups to manage and diversify their global and regional supply chains. Firstly, the major logistics players and consultancy firms which offer professional support to help businesses with their supply chain needs are in Singapore. Secondly, Singapore is home to a strong base of qualified talent in supply chain-related specialisms, such as industrial systems engineering and operations management. Thirdly, Singapore's supply chain personnel are generally in the same time zone as

many large suppliers. This allows for timely resolution of supply chain matters. Lastly, Singapore's leading universities have strong research focus areas in supply chain management. The combination of these factors provides a favourable environment for MNE groups to navigate the supply chain complexities in Asia.

Global financial centre

- 6.7 As relationships with customers and suppliers shift to Asia, companies increasingly see the need to build financial management capabilities in Asia, to get better credit rates from Asia-based banks and to manage credit risk and working capital along the supply chain.
- 6.8 Singapore stands in good stead to serve the financing needs of MNE groups. It is an international financial centre with diverse financing channels and features a vibrant ecosystem of financial institutions and professional services firms that support MNE groups' global and regional financing needs.

Professional services

- 6.9 Access to competent services providers that are proficient in a wide range of specialist topics enables the HQ to make informed decisions based on high-quality advice.
- 6.10 Singapore hosts a range of globally leading service providers, which provide high-value specialist services to serve diverse HQ needs. This includes law firms with strong regional expertise, consulting firms with deep knowledge and extensive networks across Asia, and marketing services and technology solution providers that pioneer innovative products and services based on emerging technologies.

Strong talent base

- 6.11 Where businesses are looking to centralise control, command and coordination within a single location, access to talent becomes of paramount importance. Singapore has a highly skilled workforce and offers a deep talent pool in specialised areas such as Finance, Marketing, Human Resource, Innovation, IP management and Digital technologies.
- 6.12 With the high living standards, availability of international schools, clean air and efficient public transport system, and a vibrant community, Singapore offers an attractive location for international talents to live.

Established infrastructure

Legal, regulatory and tax framework

- 6.13 Singapore offers geo-political stability, neutrality and strong governance support for hubbing of complex and multi-jurisdictional activities. In particular,

Singapore is highly regarded for its trusted legal system, strong rule of law, efficient courts, established dispute resolution regime and robust enforcement of intellectual property rights. This gives MNE groups the confidence to invest in key infrastructures and capabilities in Singapore.

Digital infrastructure and cyber resilience

6.14 Singapore has also established an extensive and sophisticated information communications network. This assures MNE groups that their business will be well-supported by a reliable digital infrastructure. In addition, Singapore continues to spearhead efforts in regional cybersecurity and cyber capacity building to enhance its position as a trusted hub.

7 Transfer pricing for activities that are centralised in Singapore

Introduction

- 7.1 The pricing of related party transactions for activities that are centralised must be at arm's length.³
- 7.2 This section explains how to analyse the related party transactions and the transfer pricing methods that may be appropriate to determine the arm's length transfer price for activities that are centralised. The explanation for other related party transactions is provided in the IRAS Transfer Pricing Guidelines.
- 7.3 This section applies to all parties involved in the activities that are centralised. For the remainder of this section, we will assume that the HQ is involved in the activities that are centralised. However, this section is equally applicable to any other entity that is involved in similar activities.

Comparability analysis

- 7.4 It is important to accurately delineate the actual related party transaction. The related party transaction would have to be understood in the context of the business of the MNE group and the nature of the transaction itself. This requires an understanding of the industry in which the MNE group operates and establishing the economically relevant characteristics of the transaction.

Functional analysis

- 7.5 The functional profile of a HQ for a related party transaction is dependent on the nature of the activities it conducts (taking into account assets used and risks assumed) which in turn define its contribution to value. Where the HQ assumes a risk for transfer pricing purposes, it needs to control the risk and has the financial capacity to assume the risk.
- 7.6 For this purpose, it is important to understand how value is generated by the MNE group as a whole, the interdependencies of the functions performed by the HQ with the rest of the group and the contributions that the HQ makes to that value creation.
- 7.7 MNE groups generate value in different ways. The importance of a value driver for one group may differ from that of another group. This is also dependent on the nature of the goods or services sold by the MNE group. For example, the branded consumer goods sector would require extensive local in-market activities if the business requires very specific local market knowledge and bespoke marketing campaigns to compete with other sellers in the market. The value of the marketing strategy and branding driver would

³ The arm's length requirement is provided in section 34D of the Income Tax Act.

be more important to this sector as compared to another sector which sells niche goods with few alternatives in the market.

Economic value created by HQ

- 7.8 Due consideration must be given to the contribution that the HQ makes to the value creation when determining the arm's length transfer price for a related party transaction. Such contribution is defined by the intensity of activities undertaken (taking into account assets used and risks assumed).
- 7.9 Contribution to value creation is not based on the number of functions performed, but the economic significance of those functions in terms of their frequency, nature and value to the respective parties to the transaction.

Functions performed by and the role of HQ

- 7.10 For the reasons outlined earlier, HQs generally conduct a wide spectrum of activities that are centralised. The activities may be performed on the entity's own account (where the HQ usually acts as a principal) or on behalf of another entity (where the entity acts as a service provider). Broadly, these can be categorised as follows⁴:
 - i. Principal in distribution, manufacturing or research and development arrangements;
 - ii. Activities relating to core business processes;
 - iii. Activities relating to administrative, technical, financial, commercial, management, coordination and control functions);
 - iv. Shareholder activities.
- 7.11 The activities commonly carried out by HQs within an MNE group could also be carried out by other non-HQs in an MNE group. These activities could be conducted at different levels of intensity and scope. The assets used, the types and extent of risks assumed may vary.

Principal in distribution, manufacturing or research and development arrangements

- 7.12 Where the HQ acts as a principal, it carries out risk taking and decision making in these arrangements. It would have qualified personnel, who are often subject matter experts, to perform these functions. Given the extensive knowledge and experience of these individuals, they optimise key functions and processes. Having collective oversight of the activities of the individual distributor, manufacturer or research and development service provider allows the MNE group to take the wider perspective of meeting group level commercial objectives and performance, in order to improve the business outcomes of the MNE group.

⁴

These categorisations are not prescriptive and not exhaustive.

7.13 For example, where the regional HQ acts as a principal to contract manufacturers within the group, it would be responsible for sourcing and procuring the raw materials and packaging materials for use by all the contract manufacturers to produce the finished goods. As a principal, it would source for raw materials and packaging materials suppliers offering better terms (given its bargaining power due to the greater volume purchased) and better quality (based on its specialised knowledge of these materials and the finished goods). The regional HQ would work with the contract manufacturers to ensure that the group's technology is correctly used to produce the goods. The regional HQ would also develop best practices with the contract manufacturers, benchmark and share these best practices across the region/group, and introduce relevant best practices from other regions, to contract manufacturers in their region. The HQ would also project and plan the overall demand for the region and convey it to the respective contract manufacturers in terms of the volume, timing and type of goods to be produced, to ensure that the projected demand is met in the most efficient way across the region.

Activities relating to core business processes

7.14 The HQ may provide services to other group entities that relate to the core business processes of the group. Typically, these business processes would form part of the supply chain of goods and/or services within the group. This would help to improve the overall performance of the group. The services are extensive and go beyond administrative and executory services. These services may be customised to the needs of the business units. In so doing, the key business risks of the MNE group will be mitigated. As a result, the value of these services tends to correlate to revenues or profits of the MNE group. Examples would include procurement services, sales and trading services, highly technical backend operations for regulatory compliance, IT services, data services etc.

Activities relating to administrative, technical, financial, commercial, management, coordination and control functions

7.15 The HQ may conduct activities relating to administrative, technical, financial, commercial, management, coordination and control functions i.e. provide centralised services.

7.16 In providing these centralised services, the HQ support the smooth running of the group entities. In this respect, the services provided are generally administrative and executory in nature and are considered corporate overheads. The services are usually not part of the supply chain of goods and/or services within the group. Centralised services may also be carried out by other entities based on the directions and policies set by the HQ. Examples of services include the issuance of invoices, the processing of accounts payable and accounts receivable, filing of local tax returns. The volume of transactions handled tends to be high and reaps the benefits from

having economies of scale. The services performed for different entities tend to be routine and standardised, thus improving efficiencies.

Shareholder activities

7.17 The HQ may conduct activities relating to other group entities that are performed from the perspective of a shareholder. For example, collation of reports from the group entities for use in the preparation of the consolidated financial statements of the group. Often, this happens if the HQ is also the parent company or regional holding company of the group entities. Generally, these activities, unlike centralised services, do not benefit the group entities. As such, the HQ cannot charge a service fee in respect of these activities.

Assets utilised by HQ

7.18 Typically, the HQ would employ assets required to run its operations. Common examples of these assets would include its operating premise (which may be leased or owned), fixtures and equipment (such as computer hardware etc.).

7.19 Where the HQ acts as a principal in a manufacturing arrangement, the HQ may own raw materials, packaging materials and finished goods. Where the HQ acts as a principal in a distribution arrangement, the HQ would own the finished goods.

7.20 The HQ may also license patents and other technologies from the Group's IP owners to carry out its responsibilities. In some other structures, the HQ itself may own relevant IP.

Risks assumed by the HQ⁵

7.21 Where the HQ assumes a risk for transfer pricing purposes, it needs to control the risk and has the financial capacity to assume the risk.

7.22 Due to the myriad of activities undertaken by HQs, there are many different types of risks that may be encountered by the HQ. The following are some examples of risks typically encountered by HQs when they act as principals and when conducting activities relating to core business processes:

⁵

The list of risks is not exhaustive. There could be other issues such as regulatory risks etc.

Table 1: Risks encountered by HQs.

Risks	Description
Market/economic risks	Overall risks in the market. Factors that affect the general economy (e.g. war, inflation, interest rate changes etc.) have an impact on levels of customer spending and consequently on the sales, volume and profits of the MNE group. Fluctuations in the prices of raw materials affect the cost of production etc.
Commercial risks	Risks arising from the decisions taken relating to the sales performance. Examples could include: - Failure of marketing initiatives undertaken. Insufficient demand generated despite new marketing initiatives undertaken. This could be due to factors such as wrong strategy undertaken, inaccurate demand research, etc. - Failure to match or counter competitor's activity. Relevant defensive action has to be taken to protect market share.
Supply chain risks	Risks relating to the supply chain. These include availability of raw and packaging materials for production, finished goods to the markets, costs of manufacturing and production efficiencies etc.
Product liability risks	Risks arising from damage or harm to the customer through the use of the products.
Inventory risks	Risks relating to product range, availability of finished goods to the market, inventory obsolescence, damage to inventory in transit etc.
Environmental risks	Risks relating to the environment. This is usually associated with manufacturing.
Capacity risks	Risks relating from under-utilisation of production capacity to over-capacity etc.
Foreign exchange risks	Risks relating to the difference in foreign exchange rates due to different transactions being conducted in currencies different from the HQ's own currency.
Operational risks	Risks arising from disruption in operations e.g. halt in services rendered etc.

7.23 Where a HQ acts as a principal, it would typically assume all/some of the key business risks arising from its activities. The HQ should have the financial capacity to assume the risk, such as the availability of credit lines from banks or group treasury.

7.24 The HQ would have 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. The HQ would also have 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. Often, the demonstration of these two capabilities can be seen in

terms of the risk management and mitigation strategies employed within the MNE group. The relevant positions in the HQ would also be vested with the authority to make the decisions relating to risk management and mitigation. The personnel in these positions would have the requisite experience, skills and qualifications. This can be seen through the profiles of these personnel. Often, these personnel tend to be more senior in job level and salary scale across the MNE group.

- 7.25 Where the HQ conducts activities relating to core business processes, it would usually manage the critical business risks for the MNE group. This is different from risk assumption as mentioned in paragraphs 7.23 and 7.24.
- 7.26 For example, the global HQ could be responsible for setting high-level global supply chain policies and procedures. It provides guidance to other entities in the implementation of these policies and procedures. These actions help to mitigate the supply chain related risk of the group. However, it would not be said to be assuming the supply chain risk. Within the group, the Regional HQ conducts strategic supply chain activities as part of its responsibilities as a principal to contract manufacturers in the region. This includes making decision on in-house or outsourced manufacturing, supplier management (e.g. identifies and selects suppliers, manages supplier performance, performs supplier capacity planning, manages contractual terms with the third-party suppliers). The regional HQ makes the decisions that relate to the control of the supply chain risk. Hence, the regional HQ can be said to be assuming the supply chain risk, provided it has the financial capacity to do so. As illustrated, while both global HQ and regional HQ are performing supply chain activities, these vary in terms of intensity and scope. The FAR profiles of both entities would differ. Consequently, the characterisation and transfer pricing methodology employed would differ.
- 7.27 One further example could include an MNE group with IP ownership centralised at the global HQ. The regional HQ provides inputs and assists the global HQ in setting the strategy and direction for the region. The regional HQ also ensures the successful implementation of the global strategy for the region. In such a situation, the regional HQ would not be taking the key business decisions and would not assume significant risks.
- 7.28 Where the HQ conducts mainly activities relating to administrative, technical, financial, commercial, management, coordination and control functions, the associated risks are generally limited to the operational risks of providing these services.

Transfer Pricing Methodology (TPM)

- 7.29 Every effort should be made to price the actual related party transaction for HQ as accurately delineated using the five methods set out in the IRAS Transfer Pricing Guidelines, any other more appropriate methods or a combination of various methods. The general approach to analyse intra-group HQ activities is no different from the approach for analysing other intra-

group transaction. If the activities performed are benefitting the Group entities, the HQ should be compensated on an arm's length basis. In the absence of compensation made to the HQ, a compensation may be deemed to have been received by the HQ. The amount of deemed compensation should be determined based on appropriate analysis and will be subject to tax in Singapore as part of the HQ's income.

- 7.30 As mentioned in section 5, HQ activities bring about benefits to the MNE group. Realistically, independent parties would not always be able to arrange their affairs in the way that members of an MNE group can. Some of the activities in the HQ context may not exist in a third party setting. The arm's length principle requires that the conditions between related parties be examined and the effect on profits due to the relationship be eliminated. Hence, the use of the appropriate transfer pricing method should work towards that outcome.
- 7.31 When selecting the most appropriate method to price HQ activities, besides considering the availability of reliable independent comparables, it is important to consider industry practices. Common industry practices provide indication of what independent parties would have agreed to pay or receive under comparable circumstances.
- 7.32 Depending on the transfer pricing model of the group, the related party transactions with the HQ could be analysed on a transaction-by-transaction basis or on an aggregate basis.

Principal in distribution, manufacturing or research and development arrangements

- 7.33 Where the HQ acts as the principal in distribution, manufacturing or research and development arrangements, these transactions are usually identifiable and can be analysed on a transaction-by-transaction basis.
- 7.34 The CUP method is appropriate if a comparable transaction can be found. This is subject to adjustments being made to improve the comparability of the transactions. In practice, it is less common to find CUPs or to make the necessary adjustments needed to use the CUP.
- 7.35 One sided methods are often used. In these transactions, the HQ would usually be the party with the more complex functional profile. Consequently, the related party would generally be the tested party. The method which can be applied in the most reliable manner and for which the most reliable comparables can be found would be applied to the tested party.
- 7.36 The costs incurred by the manufacturer and the research and development service provider would provide a value to the functions performed. These activities are usually tested using the cost-plus method or the transactional net margin method ("TNMM") using cost as the appropriate base. The mark-

up will be determined based on comparability analysis of entities of a similar functional profile.

7.37 Where distributors are responsible for driving the sales within the markets that they operate in, they are usually tested using the resale price method or the TNMM using sales as the appropriate base i.e. operating margin. In the event that the distributors do not drive sales, the distributors may be rewarded using the cost-plus method or the TNMM using cost as the appropriate base or the berry ratio⁶. The mark-up will be determined based on comparability analysis of distributors of a similar profile.

Activities relating to core business processes and activities relating to administrative, technical, financial, commercial, management, coordination and control functions

7.38 Where the HQ conducts activities relating to core business processes or provide centralised services, these transactions can be analysed either on an aggregate basis or a transaction-by-transaction basis. Where the transactions are identifiable, the transaction-by-transaction basis can be applied. However, where the 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, an aggregate basis can be considered.

7.39 The CUP method is appropriate where there is a comparable service provided to third parties or comparable services can be found to be provided between independent enterprises. This is subject to adjustments being made to improve the comparability of the transactions. In practice, it is less common to find CUPs or to make the necessary adjustments needed to use the CUP.

7.40 Where the service provider shares in the risks and consequently the rewards of their function, a profit split method which measures the gains achieved and splits it between the service provider and the other related parties may be appropriate. This is possible where the services are in respect of activities relating to core business processes and are typically part of the supply chain of goods and/services of the MNE group.

7.41 In other instances, a TPM that rewards based on the cost-plus or TNMM method would be appropriate when the value of the services provided by the centralised service provider is driven by its inputs into the process i.e. its costs. The mark-up will be determined based on comparability analysis of service providers of a similar profile. Where applicable, taxpayers can rely on IRAS' administrative practices or practices accepted by IRAS for routine support services⁷.

⁶ Subject to meeting the requirements in Section 5 of the IRAS Transfer Pricing Guidelines.

⁷ This is found in Section 14 of the IRAS Transfer Pricing Guidelines.

- 7.42 Where a HQ assumes economically significant risks and is characterised as an entrepreneur, it should receive the residual profit according to the transfer pricing method (typically, but not always, in the form of a variable return). This means the HQ would be entitled to the upside benefits and incurs the downside costs.
- 7.43 Where a HQ does not assume economically significant risks, does not make key business decisions and is characterised as a service provider, it would generally receive a fixed return. The quantum of the fixed return is dependent on the level of value add of the service.
- 7.44 See Annex A for a case study.
- 7.45 Every HQ is different. Each HQ has to be considered on its own facts and circumstances. On an overall basis, the total remuneration for the HQ should always be commensurate with its functions, assets and risks profile. Any of the five methods set out in the IRAS Transfer Pricing Guidelines, any other more appropriate methods or a combination of various methods can be used.

8 HQs in practice

- 8.1 Section 7 has described some of the possible arrangements that may be found in MNE groups that have adopted varying degree of centralisation in their business models.
- 8.2 The principles described in Section 7 would also be applicable to MNE groups that adopt decentralised business models
- 8.3 An example would be the case of a decentralised MNE group with full-risk distributors. The regional HQ provides centralised services to support these full-risk distributors. The full-risk distributors assume the significant risks for the markets that they operate in and are characterised as the entrepreneurs. Consequently, the full-risk distributors in the group are entitled to the residual profits for the markets that they operate in. The full-risk distributors would pay the regional HQ a service fee that would be determined by an appropriate transfer pricing method.

9 Transfer pricing documentation requirements

9.1 When related party transactions meet the conditions specified in Section 6 of the IRAS Transfer Pricing Guidelines, taxpayers are required to prepare transfer pricing documentation (“TP documentation”). If taxpayers fail to do so, they shall be liable to a fine not exceeding \$10,000.⁸ Where taxpayers are exempted from preparing TP documentation, IRAS encourages taxpayers to document and explain the transfer pricing arrangement.

9.2 The TP documentation should meet the requirements found in Section 6 of the IRAS Transfer Pricing Guidelines. IRAS expects the following information in the TP documentation:

- i. Economic circumstances and business strategies for the related party transaction;
- ii. Details on how value is generated by the MNE group as a whole, the inter-dependencies of the functions performed by the HQ and its related parties with the rest of the group and the contribution that the HQ and its related parties make to that value creation;
- iii. A thorough functional analysis, including a detailed analysis on risks assumption and how those risks are managed and controlled;
- iv. Reliable evidence (such as actual examples on risk materialisation) and document to support the HQ’s assumption and management of risks. It is possible that a HQ assumes certain risks but the effect of those risks is not apparent in its financial statements. The HQ has effectively managed the risks or the risks have not played out. In such a situation, the HQ must be able to explain in detail with documentation on how it manages and controls those risks;
- v. Price-setting policy, including the appropriate transfer pricing method used, basis of selecting the method, and information and document needed to justify the pricing.
- vi. Where services have been provided or received:
 - a) Benefits testing to illustrate the provision or receipt of services. Explain the benefits obtained by the related parties from the services and the necessity of the services;
 - b) Explain the choice of charging method i.e. direct charge or indirect charge and the method of allocation;
 - c) Explain how and where the cost incurred to provide the service is booked and how it is charged to the related service recipients;

⁸ The TP documentation requirement is provided in section 34F of the Income Tax Act following the rules prescribed in the Income Tax (Transfer Pricing Documentation) Rules 2018.

vii. Administrative practices used should be documented.

9.3 Where applicable, taxpayers can rely on IRAS' administrative practices or practices accepted by IRAS for routine support services⁹. Taxpayers are exempted from preparing TP documentation in this instance.

9.4 If taxpayers have prepared similar TP documentation (for example, OECD master file and local file) for the purpose 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.

9.5 It is a good practice for the HQ to set up a process to establish, monitor and review its transfer prices systematically. Taxpayers should also conduct periodic reviews to review their related party arrangements holistically and update the relative value of these arrangements in light of technological changes and other developments affecting the MNE group.

⁹ This is found in Section 14 of the IRAS Transfer Pricing Guidelines.

10 Avoiding and resolving transfer pricing dispute

- 10.1 The HQ can avoid transfer pricing disputes and obtain early tax certainty by applying for an Advance Pricing Arrangement (APA) for its related party transactions for future years.
- 10.2 Where a HQ suffers double taxation from adjustments made by IRAS or by a foreign tax authority on the transfer prices of its related party transactions, it can choose to resolve the issue through:
 - i. Taking legal remedies in the jurisdiction in which the transfer pricing adjustments are made; and/or
 - ii. Requesting IRAS to resolve the double taxation through the Mutual Agreement Procedure (MAP).

11 Contact Information

11.1 If you have any enquiries or need clarification on this e-Tax Guide, please email ct_transfer_pricing@iras.gov.sg.

Annex A - Case study of a regional HQ

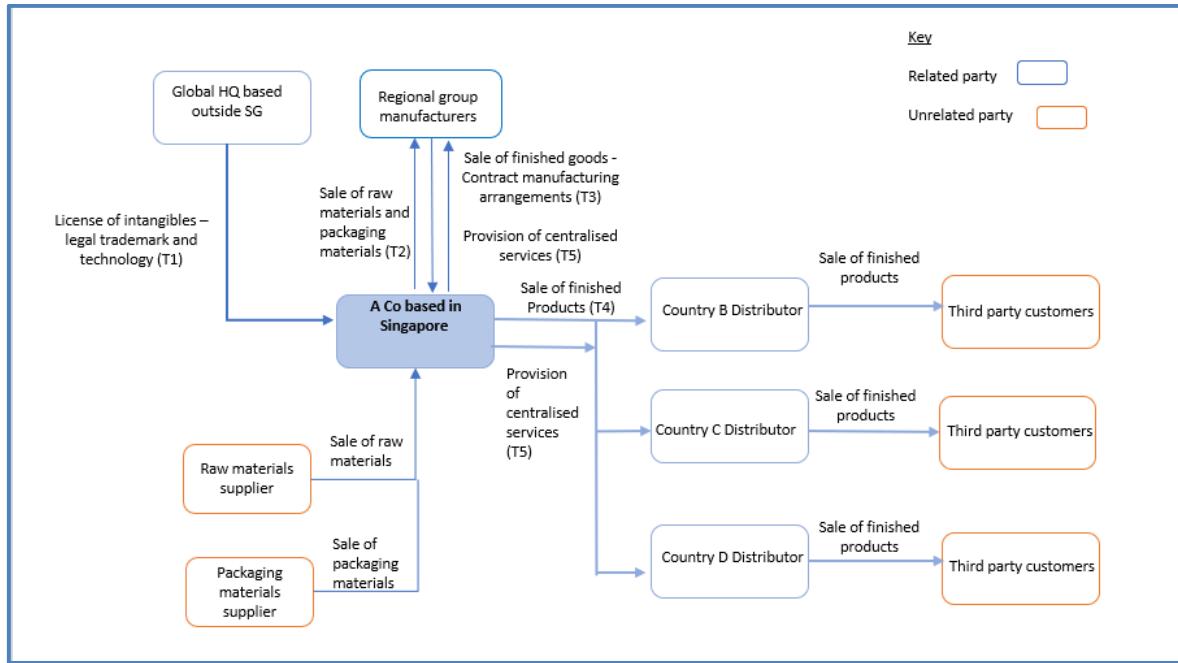


Figure 1: Transactional flows between related parties in Group A

1. MNE Group A operates in the fast-moving consumer goods ("FMCG") industry. It has established a **regional HQ** entity in Singapore, A Co., to be closer to the Asia-Pacific region.
2. The Group decided to centralise strategic decision-making activities for the Asia-Pacific region from the markets to A Co.. This will allow the Group to reap the benefits of centralisation. For example, consistency in the branding of the Group's products within the region, efficiencies from a common marketing policy with some customisation for each specific market. The regional HQ would also be in a better position to deepen its understanding of cultures and customer preferences with respect to markets in the Asia-Pacific region. Moreover, the group would be better able to react to more real-time market developments in the region, given the fast-evolving landscape of the FMCG industry. This will allow the Group to compete more effectively on cost and quality in the Asia-Pacific region.
3. The Global HQ sets high level parameters for A Co. to work within in respect of the region. A Co. makes strategic decisions on markets within the Asia-Pacific region, including the opening or closing of a distributing subsidiary, launch of a new product in existing markets, and the product mix in each market. Consequently, A Co. is responsible for the performance of the Asia-Pacific region.
4. A Co. performs centralised activities. Centralisation provides the commercial advantage that each individual entity need not duplicate efforts and perform these activities on its own, especially where there may be cost or labour

efficiencies from conducting such activities on a larger scale, on a Group-wide basis. For example, the centralisation of the collection and analysis of market data within A Co. Due to the breadth of product types in the FMCG industry, a centralised team could be more efficient in interpreting market data. This can be used in the MNE group's further decision making on aspects such as branding, sales and marketing strategies, and product pricing. A centralised team would also have better awareness of the Group's entire range of products within the Asia-Pacific region, allowing comparisons to be drawn across different markets for a given product type.

Delineated transactions

5. A Co.'s related party transactions are as follows:

Table 1: A Co's related party transactions	
Transaction ("T")	Description
T1	License of legal trademark and technology by A Co. from the Global HQ
T2	Sale of raw materials and packaging materials from A Co. to regional group manufacturers
T3	A Co.'s purchase of finished goods from regional group manufacturers
T4	Sale of finished products by A Co. to related distributors
T5	Provision of centralised services by A Co. to related manufacturers and related distributors.

Functions undertaken by A Co.

6. A Co. is the regional entrepreneur for the said products in the Asia-Pacific region. To meet its responsibilities for the region, A Co. performs the functions below.

- Licensing – It licenses the legal trademark to sell and the technology for manufacturing the finished goods from the Global HQ (T1) and carries out the entrepreneurial functions related to these products for the Asia-Pacific region.
- Procuring – A Co. is responsible for sourcing and procuring raw materials and packaging materials for use by the contract manufacturers to produce the finished goods. A Co. would ensure that the items procured are at the right price point, quality and terms of sale. A Co. is also responsible for the continuity in supply of the raw materials and the packaging materials.
- Manufacturing – A Co. works with the contract manufacturers to ensure that the licensed-in technology is correctly used to produce the finished goods. A Co. helps contract manufacturers to trouble shoot and solve

production hiccups and problems. These functions are necessary for A Co. to manage the cost of production, while meeting quality, quantity and efficiency requirements. A Co. may also work together with the manufacturers to better improve work processes to increase production yield.

- d) Demand planning – A Co. is responsible for projecting and planning the demand for the finished goods within the region. It has the expertise to supervise and advise the contract manufacturers on the production activities ranging from production planning to product delivery. A Co. works closely with the distributors on the forecasting of demand for specific products, determining the appropriate product mix and localisation of certain product specification such as packaging and language customisation etc.
- e) Supply – A Co. works with the contract manufacturers to plan production and delivery for the finished goods to physically reach the respective markets on time and at the right timing and quantity.
- f) Distribution – A Co. purchases the finished goods from the contract manufacturer. It assumes title to the goods and is responsible for storage and delivery of the finished goods. It then sells the finished goods to the distributors in the market. A Co. procures services from third-party logistics and warehouse operators.
- g) Sales and marketing – A Co. works closely with the related party distributors to ensure consistent implementation of the group marketing strategy and in-market localisation plans. This could be in terms of advertising campaigns, in-store display and marketing events, the choice of promotional materials, free gifts etc. In the event that sales targets are not met, A Co. works with the distributors on how to deal with the excess inventory and designs alternative selling action plans.
- h) Other functions – A Co. provides other centralised services to the related parties in the region. These include legal, human resource and talent management, finance and tax.

7. A Co. needs to be able to demonstrate that it has the capability to take on the functions as listed above. Generally, this can be seen by comparing the qualifications, roles and responsibilities of A Co and its related parties. The number of personnel, complemented with their respective skills, roles and responsibilities and job levels in A Co. and in the related entities are good indicators of whether A Co. has the capability and resources to take on the functions it professes to undertake. There may be instances where A Co. outsources the functions to third party providers e.g. third party logistical and warehouse operators. In such a case, A Co. has to demonstrate that it still retains the overall control over the contractors i.e. the functions and the accompanying risks are still borne by A Co.

Assets utilised by A Co.

8. A Co. owns office furniture and fixtures, computer hardware, equipment and laboratory equipment.
9. A Co. licenses patents and production technologies from the Global HQ relating to the products it is given responsibility for and pays the latter a royalty fee.
10. A Co. owns raw materials, packaging materials and finished goods.

Risks undertaken by A Co.¹⁰

11. In view of the functions above, A Co. undertakes the risks below. A Co.'s personnel has the capability to make decisions to take on, lay off or decline risk-bearing opportunities relating to these risks and they perform the decision-making function in respect of these risks. A Co.'s personnel also have 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. A Co. has the financial capacity to bear these risks:

¹⁰ The list of risks is not exhaustive. There could be other issues such as regulatory risks etc.

Table 2: Risks borne by A Co.

Risks	Description
Market/economic risks	This refers to the overall risks in the market. Factors that affect the general economy (e.g. war, inflation, interest rate changes etc.) have an impact on levels of customer spending and consequently on the sales, volume and profits of the MNE group. Fluctuations in the prices of raw materials affect the cost of production etc.
Commercial risks	<p>This refers to the risks arising from the decisions taken by the A Co.</p> <p>Examples could include:</p> <ul style="list-style-type: none"> - Failure of marketing initiatives undertaken by A Co.: Sales not materialising as demand was not generated despite new marketing initiatives undertaken. This could be due to many factors such as wrong strategy undertaken, inaccurate demand research etc. - Competitor activity: Competitors come up with a new or improved product that is in direct competition with the MNE group's product. A Co. may have to decide on the relevant defensive action to take to protect its market share. Thus, it will also bear the costs of its defensive action and the consequences.
Supply chain risks	A Co. manages the supply of products to its markets. In the case of products, this includes the end-to-end supply chain, including raw and packaging materials sourcing, ensuring that demand for products are met and ultimately ensuring the availability of finish goods to its markets. It controls costs by maintaining important manufacturing and supply arrangements and making interventions to optimise supply chain. It is responsible for designing the supply chain and making interventions needed to manage production, cut costs and/or improve efficiency. Thus, A Co. would need to bear the costs of any of its decisions for e.g. to close inefficient production facilities, invest to increase production capacity so as to meet forecasted demands etc.
Product liability risks	A Co. bears the risk arising from damage or harm to the customer through the use of the products, except where it has recourse against the IP owner.
Inventory risks	A Co. manages the product supply strategy in each market. This includes the determination of product range and initiatives in each market and ensuring the availability of finished goods to customers. A Co. is responsible for obsolete inventory, damages to inventory in transit etc.
Environmental risks	A Co., either directly or through the mechanism for remunerating the contract manufacturer, would have to bear the cost relating to all environmental risks.
Capacity risks	A Co. through the mechanism of remunerating the contract manufacturer, bears the cost of under-utilisation of production

	capacity and keeping the plants running when there is excess inventory.
Foreign exchange risks	A Co. transacts with its related parties in their respective home currencies. The costs arising from foreign exchange differences would be borne by A Co.
Operational risks	A Co. is responsible for its day-to-day operations. In the event that operations are disrupted, and the services are not rendered to the other related parties, A Co. would have to bear the consequential costs arising from it.

Characterisation of related entities

12. We assume that the regional group manufacturers are contract manufacturers and the related distributors are low risk distributors.

TPM

T1 - License of legal trademark and technology by A Co. from the Global HQ

13. A Co. would have to pay the Global HQ for the use of trademarks and manufacturing know-how. The royalty rate could be set possibly using the CUP method or other appropriate methods. Where the CUP method is appropriate, the comparability analysis should be made up of comparable agreements for the use of similar intangibles. For example, if the Global HQ licenses out the use of the patents to third parties, the rate charged, subject to the relevant comparability adjustments made, would be a possible CUP. Depending on the relative functions, assets and risks assumed by Global HQ and A Co., a profit split or residual profit split method for determining the license fees is also a possible method.

T4 - Sale of finished products by A Co. to related distributors

14. A Co. is the principal to the related distributors. Relative to A Co., the group distributors are found to be the simpler entities with the less complex functional profiles. These would be the parties to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found.
15. Based on the facts of the example, A Co. is largely in control of the distribution function. A Co. is responsible for providing the direction for the functions and working closely with the distributors. The TNMM method is commonly used for these situations. Given that the distributors are responsible for driving the sales within the markets that they operate in, the distributors would usually be rewarded with a profit level indicator using the operating margin.

T2- Sale of raw materials and packaging materials from A Co. to regional group manufacturers

T3 - A Co.'s purchase of finished goods from regional group manufacturers

16. T2 and T3 are closely inter-twined. In practice, the two transactions are examined together. A Co. is the principal to the regional group manufacturers. The regional group manufacturers would tend to be the functionally simpler party as compared to A Co. The TNMM method is commonly used for this situation. The manufacturers would usually be rewarded with a profit level indicator using the full cost mark-up. The mark-up will be determined based on comparability analysis of similar manufacturers.

T5 – A Co's provision of centralised services to related entities

17. A Co. charges a services fee to the related entities for the services rendered. A Co. could either charge the entities based on the direct charge method or the indirect charge method. For the direct charge method, A Co. would have to be able to identify and track the service rendered to each related entity and the cost incurred to provide the service. An appropriate mark-up is then identified and applied to the cost incurred. For the indirect charge method, A Co. would have to identify and track the total services rendered and the total cost incurred to provide the relevant services. A Co. would then need to identify suitable allocation keys to apportion the costs incurred in respect of the services provided to each entity. The appropriate mark-up would then be applied to compute the service charge. Likewise, the TNMM method using full cost mark-up is commonly used for this situation. The mark-up will be determined based on comparability analysis of similar service providers. Where applicable, administrative practices for routine services can also be used.
18. A summary of what could be considered an appropriate TPM in each of A Co.'s transactions is presented in Table 3 below:

Transaction	Tested party	TPM/PLI
T1	Global HQ and A Co.	CUP/PSM/RPSM
T2 & T3	Regional manufacturers	TNMM/Full cost mark-up
T4	Regional distributors	TNMM/Operating Margin
T5	A Co.	TNMM/Full cost mark-up

Arm's length remuneration (ALR)

19. Based on the above, A Co.'s remuneration would be determined as follows:

Particulars	Legend
A Co's sales to related parties	A
Add: A Co's income from services to related parties	B
Less: Royalties for intangibles (T1)	C
Less: Cost of raw materials and packaging materials (T2)	D
Less: Remuneration to regional contract manufacturers (T3)	E
Less: Remuneration to regional distributors (T4)	F
Less: Operating expenses	G
A Co's profits	H=A+B-C-D-E-F-G

20. A Co. receives residual profits after paying routine returns to its related entities. A Co.'s remuneration will be highly variable, and dependent on the Group's sales performance in the Asia-Pacific region. A Co. could expect to receive higher profits in years where MNE Group A records above average profits in the Asia-Pacific region, or low or negative profits in years where sales are poor in this region.