

Single Family Offices in Singapore

Transfer Pricing Considerations



Singapore continues to see a growth in the number and sophistication of single family offices ('SFOs'). SFOs may be established as part of the creation of a wealth planning structure to provide investment management and family administration functions. A defining feature of SFOs is that they only provide services to members of the same family. This includes investment vehicles and other entities which may be established for the benefit of those family members.

This relationship of common control means that the services provided by a SFO will often be related party transactions. It is therefore necessary to understand the transfer pricing implications of these arrangements. As part of this analysis, the unique functions and specific risk profile of a SFO should be properly considered.

Transfer pricing requirements

The *Income Tax Act (Cap. 134)* ('ITA') establishes the general transfer pricing framework in Singapore. Section 34D of the ITA enables the Comptroller to make transfer pricing adjustments where a transaction entered into between two related parties has conditions which differ from those that would arise in a dealing between unrelated parties. In addition, Section 34E of the ITA empowers Inland Revenue Authority of Singapore ('IRAS') to impose a 5 percent surcharge on transfer pricing adjustments regardless of whether there is tax payable on those adjustments. Formal transfer pricing documentation may be required by Section 34F of the ITA where a revenue threshold is satisfied. This is subject to certain exemptions and materiality thresholds.

In a typical SFO structure, the assets committed to the structure will be held through one or more investment holding entities. These operate as captive investment vehicles. It is common for these entities to apply for approval under either the Enhanced-Tier Fund tax scheme of Section 13X of the ITA or the Singapore resident fund scheme of Section 13R if the vehicle in

question is a Singapore incorporated and tax resident company. This approval is sought from the Monetary Authority of Singapore ('MAS') and may be granted by the MAS subject to any conditions it sees fit.

The MAS will generally include a condition that all related party dealings of a SFO-managed Section 13R or Section 13X investment vehicle are to be undertaken on an arm's length basis. This condition applies in parallel to Section 34D of the ITA, though the consequences of a breach are potentially a lot more drastic. A failure of an approval condition under these schemes at any time during a year will result in the tax exemptions associated with these incentives to be unavailable for that particular year. This could cause a significant amount of Singapore tax to be payable by an incentivised investment entity. Though potentially draconian in its operation, this condition makes perfect sense - it aims to deter what would otherwise be an obvious rate arbitrage between the corporate tax payable by a SFO and the exempt income derived by an approved investment vehicle from which management fees are paid.

Identifying the related parties



The definition of 'related party' is key when considering the transfer pricing position of a SFO. This term is very broadly defined under Section 13(16) of the ITA. Two parties will be considered related parties where one directly or indirectly controls the other, or if both are under common control. Control is not defined for these purposes. This is fundamentally a question of fact and is most readily identified in a corporate context where a person (which can be an individual or another company) has the majority of the voting power or "control" over a company. There may also be other factors that need to

be considered when determining whether or not two parties are related such as board level control, and how the strategic matters of the two parties are dictated.

The related party analysis tends to become a lot more nuanced where a SFO is held outside of a family wealth structure. This can arise where a SFO is owned directly by family members and the investment vehicles forming part of the broader arrangement are held through a separate family trust. In those circumstances, it can be the existence of informal control - tracing through a family matriarch or patriarch - which establishes the SFO as a related party of those investment vehicles.

The analysis becomes harder still where a SFO is engaged to provide services to an investment vehicle which may be held for the benefit of a particular family member who is not the matriarch or patriarch controlling the SFO. This could be a son or daughter who is able to exercise his or her own judgement, albeit heavily influenced by the wishes of their mother or father. The question then becomes at what point does that influence become indirect control in a manner that would render the SFO a related party of the investment vehicles held by those members of the second generation.

Related party transactions



There are potentially a number of related party transactions in a Singapore SFO structure. The most obvious of these is the pricing of the services provided by a SFO to sister companies forming part of the same group. Another clear example of a related party transaction involving a SFO is the delegation of functions (wholly, but more commonly, in part) by a Singapore SFO to an offshore parent company. This is not uncommon where a Singapore SFO is established as a subsidiary of an international SFO structure that is headquartered in another jurisdiction such as the United States or the United Kingdom.

Dealings between a family matriarch or patriarch and a SFO may also be related party transactions depending upon the circumstances. These dealings may include the

employment of a matriarch or patriarch by a SFO. The salary paid to that individual may be especially prone to scrutiny from a transfer pricing perspective if they have an established track record as an investment professional and will be applying those skills in the management of family assets by a SFO.

Direct dealings between family members and a SFO can also include the provision of family administration services. These services cover a broad spectrum and may include the management of luxury assets or the co-ordination of household personnel for example. As mentioned, these will clearly be related party transactions if a SFO provides those services directly for the benefit of the individuals who have direct or indirect control.

SFO transfer pricing



The existence of related party transactions makes it prudent for a SFO to consider transfer pricing as part of the implementation and ongoing management of a wealth planning structure. Some level of documentation should be prepared to justify the choice of transfer pricing methodology and to demonstrate a process of benchmarking and substantiation of the SFO's transfer pricing policies. Full contemporaneous transfer pricing documentation within the meaning of Section 34F of the ITA is seldom required as part of the ongoing compliance of most SFO managed structures given the revenue thresholds which apply. That said, a sufficiently substantive analysis for the internal record keeping purposes of a SFO will cover much of the same content.

There are a number of transfer pricing methodologies that may be applicable in determining the appropriate remuneration for the functions performed by a SFO. The comparable uncontrolled price method requires an evaluation of the fees charged for similar transactions between independent parties. Another method, the transactional net margin method applying a full cost mark-up, seeks to determine the arm's-length mark-up of comparable companies that perform similar services as the SFO.

The most appropriate transfer pricing method is to be selected by undertaking a functional analysis. This will generally follow the orthodox approach of identifying the functions, assets and risks of a SFO. It is important to note that the functional profile of a SFO is often not identical to that of independent fund managers, even though they may be the closest proxy for the investment management role performed by a SFO. There can be significant distinctions between the two. Such differences arise in the distribution functions, commercial

risks and legal liability faced by a SFO when compared to those of an independent fund manager.

It is particularly important to consider the nature of the investment management function performed by a SFO. The starting point is typically to identify whether a SFO is providing discretionary investment management services or non-discretionary services which are more in the nature of financial advice. This distinction is however more than merely a question of the legal documentation between the parties. There may be an overlap in the capacities of key decision makers within a SFO managed structure which can be highly relevant. This can arise where the same individuals are on the board of a SFO and an investment vehicle. In these circumstances it is hard to differentiate between an investment decision which has been made by a SFO under a discretionary authority and an investment recommendation which is made by a SFO and immediately accepted.

The provision by a SFO of family administration services is to be treated independently from the investment management role of a SFO. This includes a consideration of the most appropriate methodology and separate benchmarking unless these services are in the nature of routine support services for which IRAS has provided a safe harbour mark-up of 5%. Having differentiated the separate functions of a SFO, it should also establish the appropriate allocation keys to make sure that both direct and indirect costs are correctly apportioned. For those Singapore SFOs which are part of an international SFO structure, it is also important to be mindful of the relevance of internal comparables. These will most often come in the form of the pricing of a parent company SFO's services to investment vehicles and family members outside of Singapore.

Conclusion

The pricing of related party transactions involving a SFO should be carefully considered as part of the establishment of a wealth planning structure. A SFO would be well advised to document the selection of its chosen transfer pricing methodology and the approach taken for all related party transactions that may be identified

within a structure. This material should be updated as the functions of a SFO evolve. It may be used as a first line of defence against any queries raised by IRAS or the MAS as part of their respective reviews of a SFO and the entities it has been appointed to manage.

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