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DGIR's Powers to Make Transfer Pricing Adjustments Under s 140A Income Tax Act 1967

S v Ketua Pengarah Hasil Dalam Negeri

Further to our LHAG Update "[Landmark Decision on Transfer Pricing: Section 140A Income Tax Act 1967 and Income Tax \(Transfer Pricing\) Rules 2012](#)" of 5 February 2021, the Special Commissioners of Income Tax (**SCIT**) has recently issued its grounds of judgment. In unanimously allowing the taxpayer's appeal, the SCIT made, among others, the following points:

1) Section 140A of the Income Tax Act 1967 (ITA) is not mandatory in nature

Section 140A(3) of the ITA states:

*Where the Director General **has reason to believe** that any property or services referred to in subsection (2) is acquired or supplied at a price which is either less than or greater than the price which it might have been expected to fetch if the parties to the transaction had been independent persons dealing at arm's length, he may in determination of the gross income, adjusted income or adjusted loss, statutory income, total income or chargeable income of the person, substitute the price in respect of the transaction to reflect an arm's length price for the transaction.*

[Emphasis added.]

The Director General of Inland Revenue (**DGIR**) must first have "reason to believe" that the price in a controlled transaction is not at arm's length. Even if this is established, the DGIR does not have a mandatory duty under s 140A of the ITA to make transfer pricing adjustments on the taxpayer, but rather a discretion which he must decide whether to exercise.

2) DGIR's belated allegations of comparability defects at trial are rejected

The DGIR attempted to justify his decision to make adjustments on the basis that there were comparability defects in the selected comparable companies. The SCIT found this to be inconsistent with the DGIR's conduct during the audit. The DGIR had agreed to comparables selected and took into account the range of results from these comparables.

3) DGIR failed to justify his usage of the median as the arm's length price

The SCIT held that the DGIR had failed to justify the use of the median to determine the arm's length price and had not shown that his decision was based on any legal provisions or guidelines.

4) Tax authorities have to act properly and in good faith

The SCIT also reiterated that the DGIR has to make decisions in good faith, and on a proper basis. The SCIT cited with approval the following excerpt from the judgement of Stephens J in *Stokes & Holding (Construction) Pty Ltd v FCT* (1973) 129 CLR 617:

functions [sic] of the administrative authority is 'to form a bona fide opinion on proper grounds'. To employ them for extraneous purpose so as to subject the taxpayer to some other onerous liability, to as it were, cast a taxpayer who is not already in the frying pan into a fire which he would not otherwise be exposed, appears to me to be contrary to the clear legislative intent given expression in these provisions. [Emphasis added.]

The grounds of judgment provide helpful clarification and guidance on the appropriateness of long-standing practices adopted by the DGIR in transfer pricing matters. This includes the DGIR's habit of mechanically applying the median as the proper arm's length price, and as its basis for making transfer pricing adjustments. Taxpayers faced with similar issues in transfer pricing audits should obtain legal advice at the earliest opportunity to preserve their rights.

The taxpayer in this case was successfully represented by Dato' Nitin Nadkarni, Jason Tan Jia Xin and Chris Toh Pei Roo of the firm's Tax, SST & Customs Practice.

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If you have any queries pertaining to transfer pricing audits or tax

assessments which have been raised by the Inland Revenue Board, please contact the author or his team partners, [Dato' Nitin Nadkarni](#) and [Jason Tan Jia Xin](#), at tax@lh-ag.com

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