Singapore introduces new transfer pricing rules and guidelines

PwC Singapore
Tax Bulletin – Transfer Pricing

19 March 2018

In brief

Singapore issued subsidiary legislation under the Income Tax Act (the Act): "Income Tax (Transfer Pricing Documentation) Rules 2018" (2018 Rules), as well as the 5th edition Transfer Pricing Guidelines (5th Edn TPG) on 23 February 2018. The 2018 Rules codify transfer pricing (TP) requirements for the preparation of TP documentation (TPD) from Year of Assessment (YA) 2019 (financial year 2018). The 5th Edn TPG provide practical guidance on how these rules are to be applied. Additionally, new penalties and fines for non-compliance were introduced as part of the new legislation package.

The detailed TP rules set out the Inland Revenue Authority of Singapore (IRAS) powers to enforce the arm's length principle and reinforces the importance of "getting one's TP right" for Singapore taxpayers.

In detail

2017 amendments

The Income Tax (Amendment) Act 2017 was passed into law in October 2017 (see our October 2017 Tax Bulletin). To recap, it introduced key TP amendments including:

- Requirement to prepare contemporaneous TPD from YA 2019 for Singapore taxpayers with annual revenues more than SGD 10 million
- Increase in the penalties for not preparing contemporaneous TPD to SGD 10,000
- A 5% surcharge on the amount of TP adjustments which is automatically applicable unless waived by the IRAS
- Codification of the substance over form approach, where the IRAS is empowered to re-characterise transactions in certain cases

TPD requirements under new the 2018 Rules and 5th Edn TPG

The 2018 Rules came into force on 23 February 2018 and set out details of the contemporaneous TPD requirement from YA 2019 onwards and other TP measures introduced as part of the Income Tax (Amendment) Act 2017.

Specifically, the 2018 Rules and the 5th Edn TPG clarify how the SGD 10 million threshold will be applied and how this interacts with the existing exemption criteria established in earlier TPG editions[1] in a multi-pronged test. To determine whether the new Singapore TPD legislation applies, taxpayers will have to assess, on an annual basis, a number of factors including:

a. Whether gross revenue exceeds SGD 10 million for the current basis period;
b. Whether qualifying TPD had been prepared for the previous basis period or the period before;
c. Whether gross revenue exceeds SGD 10 million for any of these two basis periods;
d. Whether the intercompany transactions are exempted from contemporaneous TPD (generally follows the past guidance).

Based on conditions (a) and (c), once contemporaneous TPD is required, taxpayers will be expected to continue to prepare TPD until their gross revenue falls below SGD 10 million for three consecutive periods. Refer to the example[2] below for a company that receives non-routine services from its overseas related parties:

YA	Gross revenue (SGD in millions)	Service fee paid (SGD in millions)	TPD required?	Explanation
2019	12	3	Yes	Either of the two conditions is met: - Condition (a) is met as current year gross revenue is more than SGD 10 million - Condition (b) does not apply as section 34F is only effective from YA 2019 onwards
2020	9	3	Yes	Either of the two conditions is met: - Condition (a) is not met as current year gross revenue is less than SGD 10 million - Condition (b) is met as TPD is required under section 34F for the basis period for YA 2019
2021	9	3	Yes	Either of the two conditions is met: - Condition (a) is not met as current year gross revenue is less than SGD 10 million

[1] Paragraph 6.18 of the 5th Edn TPG provides the various exemption criteria for individual intercompany transactions namely (i) domestic transactions subject to the same tax rate; (ii) domestic loans where the lender is not in the business of borrowing and lending; (iii) routine support services for which a safe harbour cost-plus 5% mark-up is applied in line with IRAS' administrative guidance on routine support services; and (iv) related party transactions below the specific SGD 15 million (e.g., for purchase and sale of goods) and SGD 1 million (e.g., for services transactions).

[2] Paragraph 6.14 of the 5th Edn TPG

				- Condition (b) is met as TPD is required under section 34F for the basis period for YA 2020
2022	9	3	No	Company is exempt from preparing TPD as its gross revenue is not more than SGD 10 million for the basis period and two immediate preceding basis periods

Our observations: The new rules have introduced additional parameters for assessing whether a taxpayer has contemporaneous TPD requirements and makes this process slightly more complex. The rules also introduce a "continuity principle" to the preparation of TPD. Exemption for preparation of TPD is not available if the company's gross revenues drop temporarily under SGD 10 million.

Application of the qualifying past TPD rules

The 2018 Rules also formalised the administrative concession for the preparation of comprehensive TPD through the introduction of "qualifying past TPD" and set out the conditions for this to apply. In summary, if the relevant facts and circumstances for the taxpayer are generally the same as in the prior basis period, i.e. the bulk of the analysis continues to be relevant (functional analysis, economic analysis), the taxpayer may rely on such "qualifying past TPD" for up to two basis periods. In such cases, the taxpayer will need to issue a declaration that it is relying on qualifying past TPD for the given tax period, and attach the said TPD to it. The taxpayers will however, still be required to prepare a financial analysis, as relevant for the given tax year, to verify the transactional and profit results.

Additionally, the IRAS has introduced transitional measures, as it will accept qualifying past TPD for periods before the 2018 Rules came into effect. Specifically, TPD prepared for YA 2017 can be accepted as qualifying past TPD for YA 2018 and YA 2019, provided it meets the requirements for group file / entity file information stipulated by the 2018 Rules and 5th Edn TPG. Similarly, TPD prepared for YA 2018 can be used for YA 2019 and 2020. No earlier periods would be accepted under this measure.

More details and examples on how to apply the above rules are described in the 5th Edn TPG[3]. As there are now multiple parameters to consider, practical application of these rules will require careful case-by-case approach.

Our observations: If the conditions are met, the positive news for taxpayers are (i) greater clarity that comprehensive TPD is required every three years; and (ii) a declaration (with appropriate financial analysis) is sufficient for the intermediate years.

Other key updates within 5th Edn TPG

- **TP adjustments:** In alignment with the 2017 amendments to the Act, the 5th Edn TPG also sets out circumstances under which the IRAS will impose TP adjustments (as discussed in October 2017 Tax Bulletin). Here, the IRAS provides examples on how it will practically administer such adjustments under

[3] Paragraphs 6.27 – 6.39 of the 5th Edn TPG

the income charging provisions within the Act (e.g., when foreign sourced income is received in Singapore)[4].

- **Comparability analysis:** In line with the recommendations under the OECD[5] BEPS[6] Action Plans 8 to 10[7], the IRAS reiterates the importance of comparability analysis in a TP analysis and sets out a framework for such analysis. This framework refers to the importance of reviewing not only the contractual terms of an arrangement, but also the factual substance of the commercial or financial relations between the related parties and a comparison against the functional analysis and characteristics of goods/services/intangible property involved.[8]

- **Details on the required form and content of TPD to be prepared in Singapore (Second schedule):** Whilst Singapore has not formally adopted the OECD Masterfile / Local file requirements, the information required under the 2018 Rules is largely consistent with OECD principles. Instead of referring to Group level and Entity level information, the information required under Singapore's TPD is focused on describing businesses relevant to the Singapore taxpayer. For Singapore taxpayers adopting the OECD Masterfile/ Local file approach it is crucial to ensure that the information contained in their TPD is consistent with the Singapore TP requirements.

- **Date of TPD:** The new rules have also made clear that the date on which the TP reports have been completed will need to be stated in the reports. Consistent with the past, the IRAS has reiterated that the TPD will only be considered contemporaneous if it was prepared before the tax return filing deadline.

- **Financial transactions:** The IRAS also introduced new guidance on refinancing loans, establishing that in such cases each loan will be viewed and analysed as a separate intercompany transaction.[9] To the extent a lender extends the tenure of an existing related party loan or obtains a related party loan to repay an existing loan (i.e. re-financing), the IRAS will consider that a new loan has been obtained as at the date of the refinancing or extension of the tenure. Hence, the taxpayer would need to perform a new interest benchmarking to establish the arm's length terms and interest for the new loan instead of relying on the transfer pricing analysis carried out for the original loan.

Our observations: The above measures are a clear signal that the IRAS expects Singapore taxpayers engaging in intercompany transactions take the preparation of TPD seriously, and that it will enforce this requirement. As the consequences non-compliance have increased significantly, getting this right and ensuring full compliance with the information requirements (including form of the TPD) have become much more critical.

Further observations and implications to Singapore taxpayers

This is the first time Singapore has rewritten its TP provisions since it first legislated the arm's length principle under section 34D of the Act; and it marks a new era for TP enforcement and administration. This clearly signals the seriousness of the government in enforcing the arm's length principle in Singapore.

---

[4] 5th Edn TPG: Section 5.119
[5] Organisation of Economic Co-operation and Development
[6] Base Erosion and Profit Shifting
[7] OECD BEPS Action Plan 8-10 Final Report: Aligning Transfer Pricing Outcomes with Value Creation
[8] 5th Edn TPG: Sections 5.15 - 18.
[9] 5th Edn TPG: Section 13.27

One of the most significant updates is the legislation of TPD requirements and the tenfold increase in penalties. For taxpayers who have already been complying with the TP requirements as stipulated in the earlier IRAS TPGs, this should not result in a significant increase in compliance requirements. Taxpayers should also welcome the added certainty which the various clarifications (e.g. relating to the definition of contemporaneous, application of the various parameters for determining TPD requirements) provide.

Taxpayers who have not followed past TP guidance, should now revisit their approach to the robustness and timeliness of their TP compliance. Aside from the legislative requirements and penalties involved, robust TPD is key for articulating a taxpayer's view on where value is created and how its TP policy is aligned with these principles.

By now, many taxpayers are aware that tax authorities globally have committed to share more information (e.g., through Country-by-Country Reporting templates), have access to more data (e.g., through enhanced TPD rules, related party disclosure forms) and have access to more data analytics capabilities. Increased tax transparency is anticipated to result in more cross border disputes as tax authorities eye the same profit pie.

The IRAS has also updated its TPG in line with international expectations of TP analysis. Taxpayers should consider the key points of analysis and considerations that the IRAS (and other tax authorities) will focus on in assessing how a group's intercompany pricing compares to those between independent parties. More than before, the focus will be on substance over form. Taxpayers should therefore ensure that robust tax and TP policies, appropriate TPD and relevant supporting documentation are in place to mitigate cross-border tax risks as part of good corporate governance.

Taxpayers should also increasingly consider whether supplementary and corroborative analysis around its value drivers and distribution of overall system profits may be useful as part of its overall tax risk and dispute management strategy.

Your PwC contacts

If you would like to discuss the impact of these developments on your group's affairs, please feel free to reach out to any of the facilitators or your local PwC Contact.

Chris Woo
Head of Tax
Email: chris.woo@sg.pwc.com

Abhijit Ghosh
Partner, Tax Markets Leader
Email: abhijit.ghosh@sg.pwc.com

Paul Lau
Partner, Financial Services
Email: paul.st.lau@sg.pwc.com

Sunil Agarwal
Partner, Transfer Pricing Leader
Email: sunil.agarwal@sg.pwc.com

Falgun Thakkar
Partner, Transfer Pricing
Email: falgun.d.thakkar@sg.pwc.com

Jun Igarashi
Partner, Transfer Pricing
Email: jun.igarashi@sg.pwc.com

Vivienne Junzhao Ong
Director, Transfer Pricing
Email: vivienne.junzhao.ong@sg.pwc.com

Jie Hong Liao
Director, Transfer Pricing
Email: jie.hong.liao@sg.pwc.com

Lynn Tay
Director, Transfer Pricing (Financial Services)
Email: lynn.tay@sg.pwc.com

Andrew Fairfoull
Partner, Tax Global Structuring
Email: andrew.fairfoull@sg.pwc.com

Tan Hui Cheng
Partner, Tax Financial Services
Email: hui.cheng.tan@sg.pwc.com