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Global Transfer Pricing

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Singapore Releases New Transfer Pricing Guidelines

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The Inland Revenue Authority of Singapore (IRAS) on 6 January 2015 released revised transfer pricing guidelines. The new, comprehensive guidelines replace the transfer pricing guidelines issued in 2006, and three supplementary guidelines/circulars issued in 2008 and 2009.

Key Changes

The most significant change in the revised guidelines is the new requirement and expectation that taxpayers prepare and maintain transfer pricing documentation to substantiate that their related-party dealings are at arm's length. The concept of contemporaneous documentation has been defined in the new guidelines.

Aside from the documentation requirement, the new guidelines also contain various updates to key transfer pricing principles and approaches, discussed below.

Transfer Pricing Documentation Requirement

The new guidelines are explicit in requiring taxpayers to "prepare and keep contemporaneous records," and this is to be "part of the record-keeping requirements for tax".

What constitutes contemporaneous documentation?

The new guidelines provide specific details on the contemporaneous documentation requirement.

IRAS requires taxpayers to prepare transfer pricing documentation on a timely basis, which is defined as no later than the tax return filing date for the financial year in which the transaction takes place. The guidelines require that the date of creation or update of each document must be stated in the document."

The new guidelines also state that "in preparing contemporaneous documentation, a taxpayer may use the latest available information" at the time of preparation. If the taxpayer is subject to an audit by the IRAS or is required to submit documentation subsequently, the information used at the time of preparation will be accepted.

The new guidelines include an expanded list of required information, particularly pertaining to information at the group level, which will require more time and effort by the taxpayers to document. However, the guidelines do not require or advocate that documentation be prepared in a master file/ local file format, and there is no country-by-country reporting requirement.

Group-Level Documentation

The new guidelines require substantially more group-level details, which should provide *"a good overview of the group's businesses."* Specifically, under the new guidelines, the following types of information to be included as group-level documentation are listed:

- A worldwide organizational structure chart, showing the location and ownership linkages among all related parties;
- Description of the group's business, including:
  - the group's lines of business, products and services, geographic markets, and key competitors;
  - the industry dynamics, market, regulatory and economic conditions in which the group operates;
  - the group's business models and strategies, including any recent restructuring, acquisition, or divestiture;
  - important drivers of business profits and a list of intangibles and the related parties that legally own them;
  - the principal business activities and functions of each group entity, including charts showing the supply chains of products and services; and
  - the business relationships (services provided, goods sold, development, ownership or exploitation of intangibles, financing arrangements, etc.) among all related parties.
- The group's financial information
  - financial statements of the group relating to the lines of business involving the Singapore taxpayer

The expanded list of information required at the group level will require more time and effort from the taxpayer.

Entity Level Documentation

The new guidelines require entity-level documentation that provide sufficient details of the taxpayer's business and its transactions with related parties.

Most of the items required as entity-level documentation are already covered under Singapore's former transfer pricing guidelines, and most transfer pricing documentation prepared by Singapore taxpayers would include these details, with the exception of the following items:

- A description of the Singapore taxpayer's management structure, including a description of the individuals to whom the Singapore management reports and the countries in which those individuals maintain their principal offices; and
- An organizational chart of the Singapore taxpayer, showing the number of employees in each department.

While this information should be available to the Singapore taxpayer, it is normally not prepared or organized from a transfer pricing perspective. Care must be taken to review the information and, if necessary, reorganize it in a way that is consistent with the functional analysis of the Singapore taxpayer, and document this in the documentation.

Safe-harbor threshold for Documentation Preparation

The new guidelines provide exemption from the documentation requirement in the following situations:

- When the taxpayer transacts with a related party in Singapore and the local transactions (excluding related-party loans) are subject to the same Singapore tax rates for both parties;
- When a related domestic loan is provided between the taxpayer and a related party in Singapore, and the lender is not in the business of borrowing and lending;
- When the taxpayer applies the 5 percent cost mark-up for services that qualify as "routine" services, as defined in the guidelines;
- When the related-party transactions are covered by an agreement under an advance pricing agreement; and
- When the value or amount of the related-party transactions does not exceed the thresholds below:

Category	Threshold (S$) per financial year
Purchase of goods from all related parties	15 million
Sale of goods to all related parties	15 million
Loans owed to all related parties	15 million
Loans owed by all related parties	15 million
All other categories of related-party transactions, including: • service income • service payment • royalty income • royalty expense • rental income • rental expense	1 million per category of transactions

The introduction of the above safe-harbor thresholds for preparing transfer pricing documentation should serve to limit taxpayers' compliance and administrative costs, in relation to low-risk transactions.

Maintenance and Update of Documentation

The new guidelines now require contemporaneous transfer pricing documentation to be prepared no later than the tax return filing date of the financial year in question. However, taxpayers are not required to submit their transfer pricing documentation when the tax returns are filed. The documentation should be kept by taxpayers and submitted to IRAS within 30 days when requested to do so. No extension of this 30-day period is mentioned in the new guidelines, and it is unclear whether extensions would be granted on a case-by-case basis.

The new guidelines also recommend that transfer pricing documentation be reviewed periodically to ensure that the functional and economic analyses are still accurate and valid.

Specifically, the guidelines state that taxpayers should update their transfer pricing documentation when there are "material changes"; in the absence any such major change, documentation should be updated "at least once every three years."

Consequence of Not Preparing Contemporaneous Documentation

Failure to prepare and maintain contemporaneous documentation has the following adverse consequences:

- The lack of documentation increases the chances of transfer pricing adjustments under Section 34D of the Singapore Income Tax Act (ITA) during an audit conducted by the IRAS. The new guidelines formally incorporate (at section 7 of the guidelines) the Transfer Pricing Consultation (TPC) program, which provides guidance on the process the IRAS undertakes to audit and review taxpayers' related-party transactions, and remind taxpayers at paragraph 7.10 that during an audit or review, "IRAS may propose a tax adjustment under Section 34D of the ITA if the taxpayer's taxable profit is understated due to non-arm's length related-party transactions." IRAS has conducted the TPC program since 2008, and the availability of transfer pricing documentation has proven effective in mitigating the risk of adjustments, or in some cases, reducing the final amount of adjustments.
- The acceptability of year-end adjustments is now conditioned on contemporaneous documentation being prepared at the time of making the adjustments. Without

preparing such documentation, any year-end adjustments made (resulting in reduced income) would not be accepted for Singapore tax and transfer pricing purposes. This will be discussed in greater details in the next section.

- Consistent with the existing guidelines, IRAS may not support a taxpayer's mutual agreement procedure (MAP) application in the event of transfer pricing adjustments made by foreign tax authorities. However, the new guidelines highlight the possibility that IRAS also may decline APA requests made by the taxpayer.
- If taxpayers fail to timely submit adequate documentation upon request by IRAS, they may be penalized under Section 94(2) of the SITA for not complying with the record-keeping requirements under Sections 65, 65A, and 65B of the SITA. The penalty under Section 94(2) involves a fine not exceeding S$1,000 or a jail term not exceeding six months in lieu of payment.

In keeping with the existing guidelines, the new guidelines do not impose a specific transfer pricing penalty for lack of sufficient or timely documentation, opting instead to rely on the general penalties and record-keeping provisions in the ITA stated above. However, a clear message of intent is found at footnote 7 of page 30, where it states that "IRAS is monitoring the compliance level and may, if necessary, consider more stringent measures including specific record-keeping regulations for transfer pricing."

Other significant changes

The new guidelines also contain a number of technical updates and changes, discussed below.

Selection of Comparables

The new guidelines provide three notable points on the selection of comparables. First, the new guidelines indicate a preference for listed companies over unlisted companies as comparables, on the basis and belief that there is more publicly available information regarding the former than the latter.

Second, the guidelines state an explicit preference for local companies as comparables. A taxpayer may use suitable regional comparables, but only if an attempt has been made to identify local comparables and an insufficient number of such comparables is available.

Lastly, the guidelines provide guidance on the admission and rejection of loss-making comparables. Generally, a comparable with weighted average loss for the tested period or that has incurred a loss for more than half of the tested period is considered unreliable as a benchmark.

Choice of Profit Level Indicators (PLIs)

The new guidelines set out the commonly used PLIs in applying the transactional net margin method (TNMM), which are largely consistent with the OECD's transfer pricing guidelines.

The discussion on the Berry ratio is new and notable. The guidelines refer to the Berry ratio as an "alternative" indicator and should be use when all of the following conditions are met:

- The taxpayer acts as an intermediary purchasing goods from related parties and on-selling them to other related parties;
- The taxpayer does not perform any value-added functions other than distribution relating to the products distributed;
- The value of the functions performed by the taxpayer is not affected by the value of products distributed;
- There is a direct link between operating expenses and gross profits; and
- The taxpayer does not employ any intangibles in the particular transaction.

The overall tone of the discussion hints at the IRAS's requiring a high threshold for the use of the Berry ratio, and this is consistent with experience dealing with the IRAS during the TPC process. The guidelines view the Berry ratio as sensitive to cost classification, and hence "[u]sing it without caution can result in comparability issue." Therefore, the Berry ratio "should only be used in limited cases."

Therefore, companies that currently adopt the Berry ratio as part of their transfer pricing policy or as a method of testing arm's length results should evaluate the continued use of the ratio based on IRAS's guidance and views.

Use of Arm's Length Range and Testing of Results

The new guidelines affirm the use of the interquartile range as a reliable approach to ascertain the arm's length range. They mention that the full range "may occasionally" be used to ascertain the arm's length price, but only if it can be ascertained that all points of the range are equally reliable.

In terms of testing of financial results, the guidelines explicitly mention testing of annual results of the tested party as the appropriate approach, and that multiyear testing may be accepted only under exceptional circumstances.

Year-End Adjustments

The guidelines require taxpayers to test the financial results of the tested party annually, and to make appropriate year-end adjustments at the year-end closing of financial statements. Such year-end adjustments will be recognized for Singapore tax and transfer pricing purposes if the following conditions are met:

- Taxpayers must have in place transfer pricing analyses and contemporaneous transfer pricing documentation as defined in the new guidelines;
- Taxpayers should make the year-end adjustments symmetrically in the accounts of the affected related parties; and
- Taxpayers must make the adjustments before filing their tax returns.

Retrospective adjustments are generally not allowed as a tax deduction, although the guidelines do not preclude the possibility of bring such adjustments (if resulting in additional Singapore income) to tax.

Related-Party Loans

The new guidelines incorporate the existing guidance provided on related-party loans, and one notable addition is the discussion on the issue of credit worthiness. The new guidelines state that IRAS's preference is to evaluate credit worthiness on a stand-alone basis (i.e., of the borrower), but leaves the possibility of using the group's credit standing, if "it can be substantiated that an independent lender will similarly accept such group credit rating."

Conclusion

Transfer pricing will continue to be a focal point for IRAS. The new guidelines represent a significant milestone in Singapore's transfer pricing regime, and are continuing affirmation of IRAS's intent to ensure that taxpayers maintain sufficient transfer pricing documentation and comply with the arm's length principle.

With the release of the new guidelines, taxpayers should:

- Prepare and maintain contemporaneous documentation as required under the new guidelines. Doing so will ensure that the risk of transfer pricing controversy and disputes with IRAS are mitigated. Even in the absence of an IRAS audit, the acceptability of year-end adjustments is now conditioned on contemporaneous documentation being prepared at the time of making the adjustments. Without preparing such documentation, any year-end adjustments made (resulting in reduced income) would not be accepted for Singapore tax and transfer pricing purposes.
- For taxpayers who have prepared transfer pricing documentation, it will now be timely to consider updating the documentation, in view of the new informational requirements (for example, group information), and the guidelines' requirement to update documentation at least once every three years.
- In terms of timing of preparing documentation, since testing must be done on an annual basis and year-end adjustments are made during the closing of the financial statements, contemporaneous documentation should be prepared before the financial year-end, even though taxpayers may have until the time of filing the tax return to prepare contemporaneous documentation.
- When the new guidance on various aspects of transfer pricing analysis (such as the use of the Berry ratio, preference for local comparables, and the acceptable use of loss-makers) is relevant, it would be advisable to reevaluate the relevant transactions

or supporting analyses, and assess what additional support is required to comply with the new guidance/positions.

- The general acceptance of assessing credit-worthiness on both a stand-alone and group basis removes uncertainty on the IRAS's position on this issue. Taxpayers with related-party loans should reassess which approach would be most appropriate in their circumstances, and adjust their transfer pricing analysis or policies on such interest rate pricing accordingly (if necessary).

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