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Singapore | Tax | 12 January 2015

Singapore Transfer Pricing Developments
Singapore releases new TP guidelines

Overview

The Inland Revenue Authority of Singapore (“IRAS”) has on 6 January 2015 released revised transfer pricing (“TP”) guidelines.

The new, comprehensive guidelines replace the TP guidelines issued in 2006, and three supplementary guidelines/circulars issued in 2008 and 2009.

Key Changes

The most major change in the revised guidelines is the IRAS’ requirement and expectation that taxpayers prepare and maintain TP 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 documentation requirement, the new guidelines also contained various updates to key TP principles and approaches, which we will elaborate in the ensuing paragraphs of this article.

TP 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 TP Documentation?

To this end, the new guidelines provide specific details on the requirements of contemporaneous documentation.

Firstly, by contemporaneous documentation, IRAS requires taxpayers to prepare TP documentation on a timely basis, which specifically is 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 should be stated in the document”.*

The IRAS also stressed that *“in preparing contemporaneous documentation, a taxpayer may use the latest available information”* at the point of preparation. If the taxpayer is subject to an audit from the IRAS or is required to submit documentation subsequently, the information (e.g. financial of comparables) used at the time of preparation will be accepted.

Secondly, the new guidelines contain an expanded list of information required, 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 and local file” format / report, and there is also no country-by-country reporting requirement.

Group Level Documentation

The new guidelines now require substantially more group level details, which should present *“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 organisational 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 which legally own them;
  - the principal business activities and functions of each group entity, including charts showing the supply chains of products and services;
  - the business relationships (services provided, goods sold, development, ownership or exploitation of intangibles, financing arrangements, etc.) among all related parties.
- 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 by the taxpayers to document.

Entity Level Documentation

The new guidelines require the entity level documentation to *“provide sufficient details of the subject taxpayer’s business and the transactions with its related parties”.*

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

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

Whilst such information should be available to the Singapore taxpayer, it is normally not prepared or organised from a TP perspective. Care must be taken to review the information and if necessary, re-organise the information in a way that is consistent with the functional analysis of the Singapore taxpayer, and document these in the documentation.

Safe-harbour threshold for TP Documentation Preparation

The new guidelines provide exemption from documentation in certain situations, and this is limited to the following:

a) Where the taxpayer transacts with a related party in Singapore and such local transactions (excluding related party loans) are subject to the same Singapore tax rates for both parties;

b) Where 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;

c) Where the taxpayer applies the 5% cost mark-up for services that qualifies as “routine” services defined in the guidelines;

d) Where the related party transactions are covered by an agreement under an APA; and

e) Where the value or amount of the related party transactions does not exceed the thresholds as shown 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-harbour threshold for preparing transfer pricing documentation should serve well to limit the compliance and administrative costs of taxpayers, 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 extension 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 states that taxpayers should update their TP documentation when there are "*material changes*" and absence any such major change, TP 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"*:

a) The lack of documentation increases the chances of TP adjustments made under Section 34D of the Singapore Income Tax Act ("ITA") during an audit conducted by the IRAS. The new guidelines now formally incorporates (at section 7 of the guidelines) the Transfer Pricing Consultation ("TPC') programme, providing guidance on the process that the IRAS undertakes to audit and review taxpayers' related party transactions, and reminding 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 TPC since 2008 and the availability of TP documentation has proven effective in mitigating the risk of adjustments, or in some cases, reducing the final amount of adjustments;

b) 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 now highlight the possibility of IRAS declining APA requests made by the taxpayer as well;

c) If the taxpayers fail to timely submit adequate documentation upon request by IRAS, they may be penalised 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 6 months in lieu of payment.

In keeping with the existing guidelines, the new guidelines do not impose a specific transfer pricing penalty for the 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.*"

Highlights of other significant changes

The new guidelines also contained a number of technical updates and changes, which are elaborated in the paragraphs below.

Selection of Comparables

On the selection of comparables, there are three notable points provided in the new guidelines. Firstly, the new guidelines indicate a preference for listed companies over unlisted companies as comparables, on the basis and belief that the former has more information publicly available vis-à-vis the latter.

Secondly, 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 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 has incurred 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 TNMM, which are largely consistent with the OECD TP guidelines.

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

a) The taxpayer acts as an intermediary purchasing goods from related parties and on-selling them to other related parties;

b) The taxpayer does not perform any value-added functions other than distribution relating to the products distributed;

c) The value of the functions performed by the taxpayer is not affected by the value of products distributed;

d) There is a direct link between operating expenses and gross profits; and

e) The taxpayer does not employ any intangibles in the particular transaction.

The overall tone of the discussion hints at the IRAS' 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 being 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 which currently adopt the Berry ratio as TP policy or as a method of testing arm's length results should evaluate the continued use of the ratio based on IRAS' guidance and views.

Use of Arm's Length Range and Testing of Results

The new guidelines affirm the use of the inter-quartile range as a reliable approach to ascertain the arm's length range. It is mentioned 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 is equally reliable.

In terms testing of financial results, the guidelines provided explicit mention of testing of annual results of the tested party as the appropriate approach, and that a multi-year testing may only be accepted 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 recognised for Singapore tax and TP purposes, if the following conditions are met:

a) Taxpayers must have in place transfer pricing analyses and contemporaneous TP documentation as defined in the new guidelines;

b) Taxpayers should make the year-end adjustments symmetrically in the accounts of the affected related parties; and

c) Taxpayers must make the adjustments before filing their tax returns.

Retrospective adjustments are generally not allowed as a tax deduction, though 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' 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 represents a significant milestone in Singapore's TP regime, and is continuing affirmation of IRAS' intent in ensuring that taxpayers maintain sufficient transfer pricing documentation and comply with the arm's length principle.

With the release of the new guidelines, we would advise that each taxpayer should:

- Where no TP documentation has been prepared, to prepare and maintain contemporaneous documentation as required under the new guidelines. Doing so will ensure the risk of TP controversy and disputes with IRAS is 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 TP purposes.
- For taxpayers who have prepared TP documentation, it will now be timely to consider updating the documentation, in view of the new informational requirements (e.g. 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 tax return filing to prepare contemporaneous documentation.

- Where the new guidance on various aspects of TP analysis (such as the use of Berry ratio, preference for local comparables, acceptable use of loss makers etc.) is relevant, it would be advisable to re-evaluate 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’ position on this issue. Taxpayers with related party loans should re-assess which approach would be most appropriate in their circumstances, and adjust their TP analysis or policies on such interest rate pricing according (if necessary).

Find out more

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