
A new chapter in Singapore's transfer pricing regime

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In brief

On 6 January 2015, the Inland Revenue Authority of Singapore (IRAS) released revised Transfer Pricing Guidelines (Guidelines), an update to those first published in February 2006.

Aside from consolidating and clarifying certain aspects of the IRAS' position with regard to transfer pricing and the arm's length principle (as detailed in the first edition of the Guidelines and a number of circulars issued post February 2006), these Guidelines drive home key points which clearly resonate with the changing landscape in transfer pricing (also referred to hereinafter as "TP") globally.

In particular, the Guidelines represent the IRAS' clear recognition of the increasing complexity in TP arrangements, and the need for timely and more transparent reporting of TP within a multinational group. These are also some of the running themes observed in the recent Base Erosion and Profit Shifting (BEPS) project driven by the Organisation for Economic Co-operation and Development (OECD).

From a TP compliance perspective, the Guidelines emphasise the benefits of TP documentation being contemporaneous and IRAS' legislative powers to endorse the arm's length principle. For example, explicit mention of Section 34D of the Singapore Income Tax Act (ITA) stipulating the use of the arm's length principle for related-party transactions, and disallowance of a retrospective downward adjustment in the absence of contemporaneous TP documentation, are to name a few.

In summary, the Guidelines are helpful to taxpayers in Singapore in preparation for an increasingly transparent global tax reporting environment, by:

- providing more comprehensive and explicit guidance on the application of the arm's length principle and TP documentation requirements. In doing so, the IRAS also addresses a number of elements of ambiguity which were present before; and
- addressing the practical considerations confronting taxpayers when complying with the arm's length principle. On this note, the Guidelines focus not only on the concept of comparability and application of TP methodologies, but also on the implementation of TP policies and advise on instances when more comprehensive TP documentation may be necessary, or otherwise.

The following section of this article summarises some of the key changes. The closing section then provides insight on the implications of these Guidelines for Singapore taxpayers.

In detail

There are broad changes and clarification to the Singapore TP reporting and compliance framework as well as the application of the arm's length principle. These changes and clarification in turn affect the IRAS' position going forward with regard to the mechanisms available for taxpayers to adjust their TP, and the topic of dispute resolution.

Reporting and compliance framework

The changes in this regard are three-fold:

- Emphasis on the contemporaneous nature of TP documentation and record keeping requirements for Singapore taxpayers.
- Helpful guidance on when the IRAS expects contemporaneous TP documentation to be prepared.
- A clear move towards increased disclosure on the context of a related-party transaction within TP documentation.

The IRAS reinforces its position that taxpayers should maintain adequate TP documentation for their related-party transactions, and cites the following at Paragraph 6.4:

'Taxpayers should keep TP documentation to demonstrate their compliance with the arm's length principle as part of the record-keeping requirements for tax. Doing so will also avoid the consequence of being unable to deal with transfer pricing enforcement actions by tax authorities and double taxation arising from those actions.'

This is consistent with the IRAS' position in the 2006 version of the Guidelines. The IRAS has further reinforced its position by clearly stating now that it will not entertain

taxpayers in certain situations if they have not prepared timely TP documentation. For example, taxpayer initiated retrospective downward TP adjustments will not be allowed in the absence of contemporaneous TP documentation. Contemporaneous is further defined in the Guidelines as *'documentation and information that taxpayers have relied upon to determine the transfer price prior to or at the time of undertaking the transactions'*. The IRAS however has stated that it will accept as contemporaneous TP documentation any documentation prepared at any time no later than the time of completing and filing the tax return for the financial year in which the transaction takes place. This is for ease of compliance.

Another example where there is no change in practice, though it is evident that the IRAS is taking a more serious view, relates to the submission of TP documentation. Unlike the case previously, the IRAS has now clearly specified that TP documentation should be provided within 30 days upon request or otherwise kept for at least five years from the relevant year of assessment. In addition, the IRAS now explicitly states in the event a Singapore taxpayer is unable to provide the TP documentation upon request, it *'may be penalised under Section 94(2) of the ITA for not complying with the record keeping requirements under the ITA'*. Hence, a reminder of the IRAS' legislative power to not only endorse the arm's length principle but to also enforce TP documentation requirements when necessary.

Whilst the tone of the message delivered within the Guidelines is strong with regard to TP documentation and reporting requirements, the IRAS remains mindful of the substantial compliance and administrative cost this may

impose on taxpayers. This comes across under the IRAS' inclusion of administrative rules to simplify the requirements for TP documentation, which may help to ease the compliance burden on some taxpayers in certain situations. The most significant of these being the introduction of thresholds for the value of related-party transactions; if the quantum taxpayer's related-party transactions do not exceed certain thresholds detailed therein, there will be no expectation from the IRAS to prepare TP documentation. In reality however, taxpayers headquartered in Singapore and a large majority of multinational companies with taxable presence in Singapore, exceed those thresholds. It is also important to note that the simplification of requirements does not exempt taxpayers from compliance with the arm's length principle. Taxpayers will be exposed to upward TP adjustment by the IRAS if they are unable to substantiate that TP for related-party transactions are at arm's length and the IRAS has reasons to consider that profits have been understated through improper TP.

Finally, it is also clear from the Guidelines that the IRAS expects increased disclosure and transparency from taxpayers when compiling TP documentation. The Guidelines cite additional information including important drivers of business profit, list of intangibles and intangible owners, and the financial statements of the group relating to the lines of business involving the Singapore taxpayer.

Whilst in practice, many taxpayers in Singapore already include entity specific detail within their TP documentation, the reference to broader group information is a step closer to the country-by-country reporting initiative we have observed from the BEPS project.

Application of the arm's length principle

The Guidelines continue to endorse the arm's length principle for related party transactions. In doing so, the IRAS provides increased commentary and in some cases, its explicit position with regard to the conduct of comparability/economic analyses and application of the TP methodologies. This is timely recognition of the increasing complexity in taxpayers' related-party arrangements and structures now as compared to merely a decade ago. We explore a few of their key points below.

On the topic of comparability, the IRAS places importance on both the nature of a transaction and the commercial and economic circumstances of that transaction. The nature and economic circumstances for a transaction have been general consensus in past years; mention of the potential impact a difference in commercial and/or industry/country specific policies can have on comparability is a new factor that has been included for consideration. Of interest, the IRAS cites government policies and regulations such as price controls, and the assessment of political changes on business strategies, as factors that have the potential to affect comparability.

Application of the TP methodologies remains, by and large, consistent with international practice, as is the IRAS' degree of preference for one method over another. However, there is more comprehensive guidance provided on how those methods should now be applied in practice.

A couple of the changes/clarifications in content relate specifically to the application of the Transactional Net Margin method (TNMM) and Cost Plus. For example, the Guidelines explicitly set out the necessary conditions which should be fulfilled/present in a transaction

before the Berry Ratio can be applied as a profit level indicator, and that it should only be used in limited cases. In computing a cost plus result, the IRAS provides additional information on how the cost base can be reasonably derived in accordance with the Singapore Financial Reporting Standards when the service provider is a Singapore taxpayer.

More generally, when assessing the arm's length nature of a transaction, the Guidelines extend strong and conclusive views with regard to the reliance on loss making companies as benchmarks (including instances when they should not be used), and flexibility around the definition and use of the arm's length range.

Other changes

The Guidelines consolidate the circulars on TP consultation, advance pricing arrangements (APAs) and the transfer pricing of related-party loans and services, which were released subsequent to the 2006 version of the Guidelines. In doing so, there are no significant changes to those guidance and procedures, albeit there is now a more detailed commentary.

The key change we observe is the IRAS expressing explicit position with regard to self-initiated TP adjustments and dispute resolution procedure, which are tools taxpayers frequently exercise to achieve an arm's length outcome and to avoid double taxation. The IRAS explicitly emphasises the importance of contemporaneous TP documentation demonstrating a taxpayer's reasonable efforts to apply the arm's length principle, before it will even entertain certain dispute resolution procedure and/or TP adjustments.

The takeaway

Implications for taxpayers

The issuance of the Guidelines is a clear indication of the IRAS'

endorsement of international best practices for the preparation of TP documentation, to ensure local taxpayers maintain adequate and appropriate analysis and documentation to demonstrate compliance with the arm's length principle in the face of a changing global tax environment. The IRAS goes a step further in the Guidelines, citing more than once, its legislative powers to enforce the arm's length principle (Section 34D of the ITA) and TP documentation requirements (by invoking Section 94(2) of the ITA), in the event a taxpayer is unable to provide TP documentation when requested by the IRAS. The IRAS has also indicated, in a footnote, that it may consider more stringent measures including specific record-keeping regulations for TP in future where necessary.

In terms of adopting the Guidelines, whilst most of the requirements laid out are not new and should not require major changes in taxpayers' practices for the preparation of TP documentation, they provide explicit detail on documentation requirements and address ambiguity (in the past) on common topics for compliance with the arm's length principle.

Implementation-wise, the Guidelines are likely to provide for increased visibility over Group transfer pricing policies, and a review of those policies, implementation and review procedures. The Guidelines appear to prepare local taxpayers for the recent outcomes we have observed under BEPS with regard to master file, local file documentation and country-by-country reporting, and likely reaction from other tax authorities.

In our opinion, it is increasingly critical for Singapore taxpayers to engage in TP risk management and planning. For Singapore taxpayers headquartered in Singapore, the Guidelines serve as a basis to review

where current operations fall short of meeting the revised expectations of the IRAS.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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