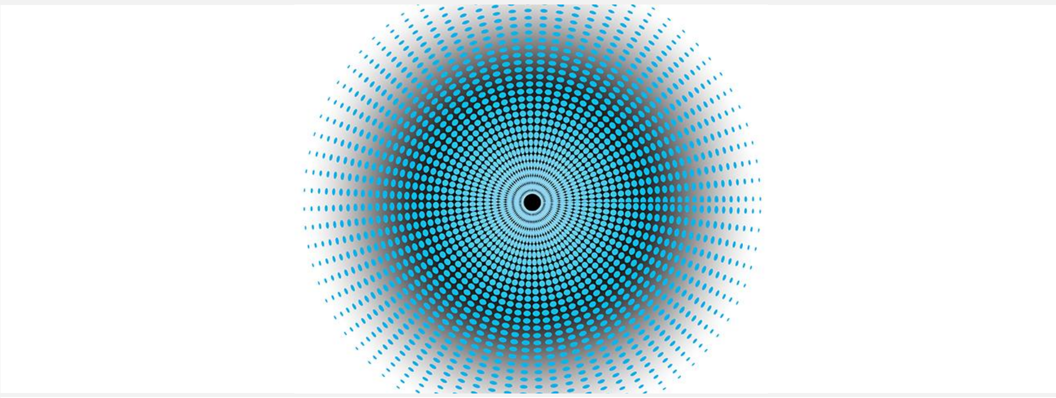
Singapore | Business Tax | 30 April 2018



Singapore Business Tax developments
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IRAS updates tax treatment of service companies

The Inland Revenue Authority of Singapore (IRAS) has updated its website to provide further details on the tax treatment of service companies applying the “cost-plus mark-up” basis (CM basis) of taxation.

Background

In the context of the CM basis of taxation, a “service company” refers to a company that provides services only to related companies. Such services include management services, technical support services, procurement, administrative support services, and customer support services.

Briefly, under the CM basis of taxation, the IRAS is prepared to allow the chargeable income of a service company to be computed based on the mark-up on the total expenditure incurred by the service company (as per the Singapore Financial Reporting Standards) without any further tax adjustments. Where services are provided at cost or at non-arm's length prices to related companies, the IRAS would impute a profit on the transaction so as to reflect the market price that would be charged if the transaction was conducted on an arm's length basis. It is relevant to note that the CM basis of taxation is an administrative practice of the IRAS and is not provided in law.

In Deloitte Singapore’s alert issued on 15 June 2017, we highlighted that the IRAS is tightening the eligibility conditions for companies to apply the CM basis of taxation. Please refer to the earlier alert here for details.

Update on the application of CM basis

Companies that do not qualify for the CM basis going forward will have to transit to the Normal Trading Company (NTC) basis, latest by YA 2020 (i.e., YA 2019 is the last YA where the CM basis is accepted). Early transition is permitted.

The following transitional rules apply:

Tax item	Tax treatment in the transition YA and after
Section 14Q deduction for renovation or refurbishment expenditure incurred prior to transition YA	Section 14Q deduction will be allowed only if the expenditure has been capitalised in the accounts, and will be computed based on the opening net book value at the start of the transition YA and the relevant 3-year period will commence from the transition YA.
Capital allowances on qualifying plant and machinery acquired prior to transition YA	Capital allowances will be computed based on the opening net book value of the qualifying plant and machinery at the start of the transition YA. Any balancing charge shall not exceed its cost in the event of disposal of the qualifying plant or machinery in or after the transition YA. Productivity and Innovation Credit (PIC) claim will only be allowed in the year of acquisition. As such, only PIC automation equipment acquired in YA 2018 will qualify for PIC claim if the transition YA is YA 2018.
General provisions made prior to the transition YA	Any provisions utilised will be allowed deduction or any provision written back will not be taxed in the transition YA or after.
Specific provisions made prior to the transition YA	Any provisions utilised will not be allowed deduction and any provision written back will be taxed in the transition YA or after. This is because the provisions would be considered to have been

	claimed in the year the provision was made.
PIC claim brought forward and unutilised donations	There is no PIC claim brought forward or unutilised donation since the company is under the CM basis previously.

Deloitte Singapore's views

1. Going forward, the scope and application of the CM basis of taxation will narrow

   Based on information provided by the IRAS in its website, for the CM basis of taxation to apply, amongst others:

   - The company must only be providing services to related parties and such services have to fall within the list of routine support services as stipulated under Annex C of the Transfer Pricing Guidelines (Fifth Edition); and
   - The mark-up must be 5%.

   To illustrate:

Activities carried on	Provides routine support services	Provides routine support services	Provides routine support services and holds investments
Counter-party	Related companies only	Related companies only	Related companies only
Mark-up	5%	6% (arm's length fee)	5%
CM basis allowed?	Yes	No, notwithstanding mark-up is within arm's length range	No, not "purely" providing services

2. Should a company that is on the CM basis of taxation transit to NTC basis of taxation, and if so, when should it make the transition?

   This question is applicable to companies that:

- Are eligible for the CM basis of taxation going forward, but have the option of transiting to the NTC basis; or
- Are not eligible for the CM basis of taxation going forward and must transit to the NTC basis by YA 2020.

Here are some (non-exhaustive) considerations:

CM basis	NTC basis
Generally, no tax adjustments required, thus reducing administrative/tax compliance costs	· Tax adjustments are required for, amongst others, non-deductible expenditure · Company may claim double and further deduction on qualifying expenditure, such as expenditure incurred on overseas investment development, etc. · Company may claim enhanced deductions on qualifying donations · Company may claim enhanced allowances or deductions under the PIC Scheme for qualifying spending incurred in the YA 2018 on PIC automation equipment or employee training*

*The claim for PIC may only be made if the company transits to the NTC basis in the YA 2018, which is the last year to claim PIC enhanced allowances or deductions. The IRAS has not indicated what the PIC expenditure cap is for a company that transits from the CM basis to the NTC basis in the YA 2018.

We hope that you find this newsletter useful and we welcome your feedback.

Contacts

For more information or assistance, please contact the Deloitte Singapore tax professionals below, or your usual Deloitte contact.

Daniel Ho
Tax Partner
Deloitte Singapore

Chua Kong Ping
Tax Senior Manager
Deloitte Singapore

+65 6216 3189
danho@deloitte.com

+65 6530 5516
kchua@deloitte.com

Deloitte Touche Tohmatsu Limited
6 Shenton Way, OUE Downtown 2, #33-00
Singapore 068809