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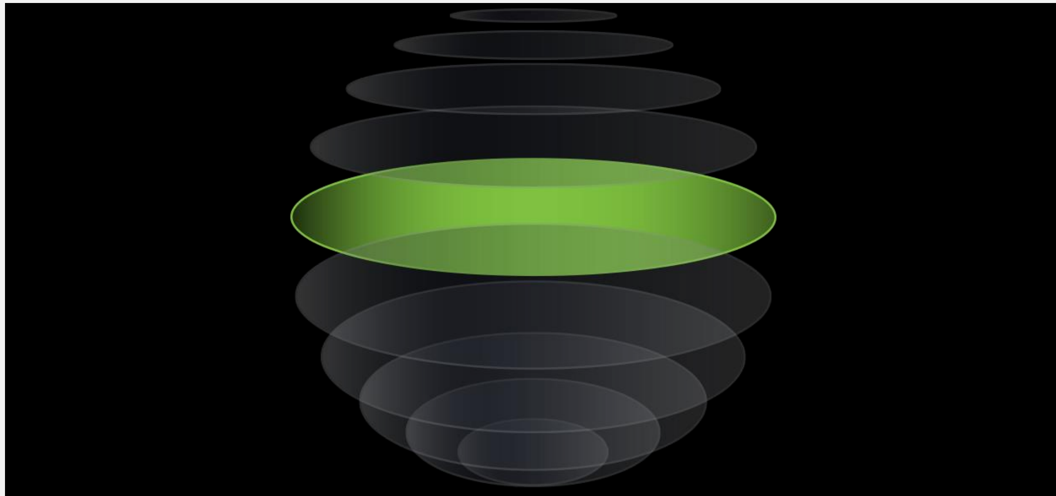

Singapore Transfer Pricing (TP) developments—Mandatory TP documentation legislation and revised TP Guidelines

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Background

Subsequent to our newsletter "*Singapore proposes to legislate mandatory TP documentation requirement and penalties*" dated 28 June 2017, the proposed legislation has been passed in Parliament on 26 October 2017.

On 23 February 2018, the Income Tax (Transfer Pricing Documentation) Rules 2018 (referred to as the "Rules") were gazetted and the Inland Revenue Authority of Singapore (IRAS) concurrently issued revised TP Guidelines, detailing the changes introduced in the new legislation and the Rules.

Even though most of the requirements under the new legislation are not new (and in fact many are already mandatory or required under the current TP Guidelines), the introduction of the new legislation marks a distinct shift from the current, practice-based TP regime to a more formal, rule-based regime, where requirements are now codified in tax legislation and rules.

Most notably with regard to transfer pricing documentation (TPD), which is currently mandatory "as part of the record-keeping requirements for tax" (i.e., under the general record

keeping provisions of Section 67 of the Singapore Income Tax Act (SITA)) with certain exemptions provided under the current TP Guidelines, mandatory documentation is now required under the newly legislated Section 34F of the SITA, and exemptions are also formally codified under the Rules.

The following sections provide the key highlights of the new legislation, the Rules as well as the revised TP Guidelines.

Key highlights

Mandatory TPD requirement and exemptions

The new Section 34F introduced in the SITA requires the preparation and maintenance of contemporaneous and adequate TPD with effect from Year of Assessment (YA) 2019 (i.e., financial year ending 2018), and the revised TP Guidelines referred to this as "TPD under Section 34F".

It is important to note that even before the enactment of Section 34F, mandatory TPD is already required under Section 67 of the SITA and the current TP Guidelines. This has not changed and continues to apply to TPD required for YA 2018 (financial year ending 2017) and before. With the enactment of Section 34F, TPD prepared with effect from YA 2019 under the requirements of this new Section is referred to as "TPD under Section 34F".

The TPD requirements under the new Section 34F are largely similar to those under the current requirements, namely, the requirement to prepare the TPD (including the level and type of information to be documented) no later than the filing deadline of the tax return, the submission of the TPD to the IRAS within 30 days of such request, the retention of the TPD for five years are affirmed but now codified in the new legislation and the Rules.

The notable difference is the introduction of an additional exemption from preparing TPD, based on a test of whether the entity's annual gross revenue (i.e., income from a trade or business) exceeds S$10 million. The existing exemption thresholds remain and this new exemption serves as an additional safe-harbour to these existing thresholds.

The new exemption comprises of two conditions, and an entity only qualifies for the exemption if it meets both, as follows:

a) Annual gross revenue from their trade or business for the basis period concerned does not exceed S$10 million; and

b) It was not required to prepare TPD under Section 34F for the immediate preceding year—YA 2020 would be the

first year that this test will be applicable. However, if the entity breaches this test (i.e., it was required to prepare TPD for the immediate preceding year) but its annual gross revenue does not exceed S$10 million for the immediate two preceding years, the entity is considered to have met this test.

To determine if exemption from TPD is available, an entity would first need to assess if it meets with the conditions of the new exemption. If it does, it does not need to prepare TPD.

If the entity does not meet the conditions of the new exemption, it would need to prepare TPD but it may avail itself certain specific/transaction exemption thresholds. These are largely the same as the current exemption thresholds, though now specifically codified under the Rules, and they are as follows:

a) Related party domestic transaction subject to same tax rate—transactions between related parties in Singapore (excluding related party loan) where both parties are subject to the same Singapore tax rates, or exempt from Singapore tax.

b) Related party domestic loan—a loan provided between related parties in Singapore, and the lender is not in the business of borrowing and lending money.

c) Related party loan where the safe harbor interest margin is applied.

d) Provision of support services, qualifying as "routine" services on which 5% cost mark-up is applied.

e) Related party transaction covered by an Advance Pricing Arrangement (APA).

f) Related party transactions not exceeding the following values:

Type of Transaction	Value (S$)
Purchase of goods	15 million
Sales of goods	15 million
Loan to related party	15 million
Loan from related party	15 million
Provision of service	1 million
Receipt of service	1 million
Grant of right to use property or lease	1 million
Receipt of right to use property or lease	1 million
Guarantee provided	1 million
Guarantee received	1 million
Any other transaction	1 million

The Rules and Guidelines maintain by and large, the same level of information and format required for the TPD. However, the new Guidelines (at paragraph 6.25) accepts TPD in the format of OECD style master file and local file, as long as the required information is documented.

Penalties and consequences of not preparing TPD

Under the new Section 34F(8), failure to prepare the required TPD constitutes an offence, and the taxpayer is liable to a fine/penalty of up to S$10,000 per offence.

More specifically, a taxpayer can be liable to the fine for the following non-compliance:

a) Not preparing or maintaining TPD based on the requirements under the Rules;

b) Not preparing TPD by the time for the making of the tax return;

c) Not retaining the TPD for a period of 5 years;

d) Not submitting the TPD within 30 days from written request by the IRAS; or

e) Providing any documentation or information that the taxpayer knows to be false or misleading.

This marks a significant increase in the penalty for not preparing TPD. Before the enactment of Section 34F, there is no specific penalty for the failure to prepare TPD or failure to submit adequate documentation on time upon request. These previously may be subject to the general offence penalty under Section 94(2) of the SITA, which may involve a fine not exceeding S$1,000.

The new penalty regime will take effect from YA 2019.

Updating of TPD

The current Guidelines states that "[t]axpayers should update their TP documentation when there are material changes to the operating conditions that impact their functional analysis or transfer pricing analysis. In any case, IRAS encourages taxpayers to update their TP documentation at least once every three years."

In other words, the Guidelines require a major update of the TPD every three years (unless there is material change to the operating conditions of the taxpayer or industry), and encourages that a review and simple update of the

benchmarking results be carried out in the intervening two years.

The broad approach to updating of TPD is retained with the enactment of Section 34F, but a formal framework (with detailed conditions) is now prescribed under the new Rules.

The revised Guidelines state that "taxpayers are to review and refresh their TP documentation annually. This will result in taxpayers having to prepare a TP documentation for each basis period", but that "to reduce taxpayers' compliance burden, IRAS allows taxpayers to use the TPD they have prepared previously to support the transfer price…if that past TP documentation is a qualifying past TP documentation".

A "qualifying past TP documentation" is a past TP documentation prepared in one or two preceding years (i.e., TPD prepared in Year 1, can potentially be used for Years 2 and 3, whereas a major update/new TPD will be required for Year 4), provided <u>also</u> that the following specific conditions are met as well:

a) The transaction documented in the past TPD is the same type as the transaction in the current year;

b) The transaction documented in the past TPD are undertaken with the same related parties;

c) The past TPD was prepared in accordance with the requirements under the Rules, properly dated and prepared in English; and

d) The information contained in the past TPD on the following matters remain relevant in the current year:

   - The commercial or financial relations between the taxpayers and their related parties;
   - The conditions made or imposed between the taxpayers and their related parties;
   - The transfer pricing method that is used for the transaction; and
   - The arm's length conditions within the meaning of Section 34D, including comparability with the conditions/circumstances observed between independent parties.

To adopt past TPD as qualifying TPD for Years 2 and 3 (subsequent to the preparation of contemporaneous TPD in

Year 1), taxpayers are required to prepare a "simplified TPD" comprising:

- A declaration, confirming that the conditions/circumstances (in Years 2 and 3) met the conditions stated above; and
- The past TPD as an attachment.

The "simplified TPD" should be prepared by the tax return filing timeline and would need to be submitted upon request.

Where a taxpayer qualifies for the simplified TPD, he nonetheless has the choice not to adopt the simplified TPD but to prepare new TPD.

TP adjustments and surcharge

The existing Section 34D of the SITA currently empowers the IRAS to make a tax adjustment if the taxpayer's taxable profit is understated due to non-arm's length related party transactions.

Section 34D will be significantly expanded to clarify that the determination of arm's length principle would also consider arm's length "circumstances" i.e., whether third parties would reasonably enter or not enter into similar transactions/arrangements. The new legislation provides the IRAS with the power to disregard the form of actual commercial or financial relations between related parties where the substance of the transaction is inconsistent with the form of the transaction and for the IRAS to make necessary adjustments.

The new Guidelines contain substantial new/re-write with explicit mention of the making of TP adjustments, such as paragraphs 5.117 to 5.124.

The new Section 34E also introduces a new surcharge on any TP adjustment made.

Where the IRAS has made an TP adjustment under Section 34D to increase the amount of income, reduce the amount of deduction/allowance or reduce the amount of loss, a surcharge equal to 5% of the amount of increase in income or reduction in deduction, allowance or losses will be imposed.

The surcharge applies, whether or not any additional tax is payable arising from the adjustments (e.g., where unabsorbed tax losses, pioneer incentive exemption is available), and is payable within one month from the issuance of the notice of surcharge.

The surcharge will apply from YA 2019.

Deloitte's observations and views

The new legislation and Rules represent a significant move from the current, practice-based regime to a more rule-based one.

Though the key requirements of preparing and updating of TPD remain largely unchanged, the introduction of the specific TP penalty as well as surcharge raises the cost of non-compliance to the arm's length principle and documentation requirements considerably.

The introduction of the additional exemption threshold based on the annual gross revenue would relieve smaller companies from TPD requirements, even though its application is somewhat complex, particularly in the years subsequent to YA 2019.

More importantly, the onus is on the taxpayer to demonstrate the applicability of the exemption to his circumstances, taking into careful consideration that a wrong determination could now give rise to penalty (fine up to S$10,000 per offence) under the new Section 34F(8).

Similarly, in relying on past TPD as qualifying TPD, the onus is also on the taxpayer to show that the relevant conditions have been met, and bearing in mind that if the past TPD have been inappropriately relied on as current TPD, the penalty/fine could arise.

The Guidelines therefore suggests that notwithstanding the above, "to better manage their transfer pricing risk, IRAS encourages taxpayers to prepare TP documentation following the TP Documentation Rules and the guidance provided in this section".

With respect to TPD for YA 2018, we note that many taxpayers have prepared new or have undertaken a major update of their TPD for YA 2015, following the release of mandatory TPD requirements in the TP Guidelines in 2015 then. These taxpayers are required to conduct a major update of the TPD in YA 2018. In this regard, the new Guidelines (at paragraph 6.36) specifically caters for such "seamless" transition between the old regime and new, by accepting that past TPD prepared before the enactment of Section 34F can still be considered as qualifying TPD for future years. Therefore, these taxpayers should prepare new TPD (or conduct a major update of the TPD prepared in YA 2015) for YA 2018, thus ensuring that they are in compliance with the current requirements for YA 2018, and being assured that the YA 2018 TPD can be used as qualifying TPD (provided conditions are met) in subsequent YAs.

The newly introduced surcharge applies to all TP adjustments, irrespective of whether there is tax payable. For companies that do not pay tax (e.g., tax losses, tax incentive), it would be necessary to evaluate the sufficiency of existing TPD, to ensure that these are appropriately prepared or updated to meet with the new requirements and to minimise the incidence of surcharge.

With mandatory TPD requirement now legislated and the introduction of significant penalties (fine and surcharges), as well as substantial re-write to the Guidelines with explicit mention of the making of TP adjustments, the IRAS is sending a clear signal that it is moving from a practice-based approach to a formal TP regime where it will seek to enforce compliance including the imposition of penalties.

Therefore, companies should ensure that it has proper and contemporaneous TPD. More importantly, with the stakes for non-compliance raised considerably under these proposed changes, companies should also ensure that they devote appropriate attention and processes to address related party transactions and the compliance with the new requirements.

Find out more

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