

## Transfer Pricing Developments in Singapore: New 2016 Guidance Released by IRAS



### Overview

On 4 January 2016, the Inland Revenue Authority of Singapore (IRAS) released the third edition of its transfer pricing guidance (TPG3) for Singapore taxpayers.

Compared to the previous edition, TPG3 contains expanded IRAS' viewpoints on several fronts – especially on:

- the administrative process leading to an Advance Pricing Arrangement (APA); and
- the derivation of the cost base to which the cost plus mark-up is to be applied.

In the following paragraphs we have provided a summary of the key concepts in TPG3, including those that have been carried forward unchanged from the previous edition.

TPG3 spans over a hundred pages, and it is an update and expansion of all the transfer pricing-related guidance released by IRAS previously.

IRAS' purpose behind its guidance is twofold. First, to foster greater understanding of transfer pricing and compliance amongst Singapore taxpayers.

Secondly, to align Singapore's transfer pricing requirements with international transfer pricing developments arising from the OECD's Base Erosion and Profit Shifting (BEPS) initiatives.

### Transfer pricing requirements in the Singapore Income Tax Act

To provide legislative weight and to reinforce compliance, IRAS makes explicit reference to certain sections of the Singapore Income Tax Act (SITA) inside TPG3. These include Section 34D (Transactions not at arm's length), as well as Sections 32 and 53. Section 34D closely parallels the OECD's Arm's-Length Principle, and allows IRAS to adjust a taxpayer's income upwards and tax the extra amount accordingly, if the related parties in the transaction have not dealt with each other in an arm's-length, market-based manner.

In addition, IRAS reminds taxpayers that they are expected to maintain timely and adequate transfer pricing documentation as part of the record keeping requirements in the SITA. Non-compliant taxpayers may be penalized under Section 94(2) of the SITA.

IRAS is also of the view that since their guidance elaborates on existing legislation and expectations, the concepts therein should already have been adopted by the taxpayers. This means that the guidance is already in effect at time of its publication.

## **Transfer pricing documentation**

### **Documentation requirements**

IRAS requires transfer pricing documentation to be maintained on a “contemporaneous” basis – that is, the documentation should be in existence at the time of undertaking the transactions. However, IRAS will also accept documentation that has been adequately completed by the tax filing due date (in the year following the financial year end of the taxpayer).

### **Documentation content**

TPG3 provides guidance on the information to be included in transfer pricing documentation. This is to be organised into group-level and entity-level information.

Group-level information is focused on items of relevance to transactions with the Singapore taxpayer. There is also an emphasis on describing the value chain and contributions made by related parties along the chain.

At the entity level, taxpayers are expected to provide information specific to the Singapore taxpayer’s operations.

Such information remains similar to that required by IRAS previously, including:

- details on the related-party transactions including the parties involved and quantum of transactions;
- analysis of functions performed, risks undertaken, and assets used by each party to the transaction;
- rationale for the chosen transfer pricing method and tested party;
- approach and details on comparability analyses undertaken; and
- derivation of an arm’s-length price range.

Where taxpayers have prepared relevant transfer pricing documentation for compliance in other tax jurisdictions, TPG3 indicates that such documentation may form “part of” the documentation for Singapore tax purposes. Hence, while regional or global documentation can be a starting point, it may be insufficient for full compliance with Singapore requirements.

### **Exemptions from documentation**

IRAS recognises that the requirements may be onerous for taxpayers with smaller related-party transactions. Hence, for these, as well as for

transactions where the risk of tax leakages is small, there are certain exemptions from documentation.

For example, product transactions below SG\$15 million, services transactions below SG\$1 million, and either type of transactions between Singapore parties with the same tax rate are exempt from documentation. However, an exemption from documentation does not equate to an exemption from applying arm’s-length pricing.

### **Clarification of technical items**

TPG3 contains detailed viewpoints on items such as the use of multiple-year data for comparability analyses, treatment of loss-making comparables, and viewpoints regarding the use of local, private, and public companies in the benchmarking process.

Detailed insights on the use of various transfer pricing methods and profit level indicators, under different circumstances, are also provided. Of particular note, specific conditions are also listed for the use of the Berry Ratio. This may be of interest for trading companies who have used the Berry Ratio in testing their transfer prices.

### **Using safe harbours to set profitability**

TPG3 reaffirms the existing cost plus five percent safe harbour mark-up as a proxy for arm’s-length compensation on intra-group services. This safe harbour treatment applies only to defined routine services, under certain conditions. While not in TPG3, we note that IRAS is contemplating the extension of the safe harbour concept to the interest rate charged on intra-group loans.

### **Advance Pricing Arrangements**

APAs are formal agreements between taxpayers and authorities on the transfer pricing method and the approach governing covered related-party transactions. With an APA in place, taxpayers can mitigate uncertainty and the risk of disputes over transfer prices. Accordingly, APAs have grown in popularity with a growing number filed by taxpayers over the past few years. A substantive amount of the changes found in TPG3 are focused on the APA application process – with details on IRAS’ expectations over application timeline, covered period, information to be submitted, etc.

### **Attribution of profits to permanent establishment**

TPG3 formalises IRAS’ viewpoint that no further attribution of profits to a permanent establishment in Singapore is likely when arm’s-length compensation has been received. It also outlines the conditions that are required to be met by taxpayers for the above outcome.

### Transfer pricing risk indicators

IRAS has reviewed taxpayers' transfer pricing compliance partly through the Transfer Pricing Consultation (TPC) process. The process typically starts with IRAS requesting information on related-party transactions through a questionnaire, and it is likely to be followed by site visits and further rounds of queries.

For companies assessing their transfer pricing exposure, TPG3 provides insights on the risk indicators IRAS uses to select taxpayers for TPC. These include the value of related-party transactions and business performance over time.

"Red flags" that IRAS considers to be indicative of high transfer pricing risks include:

- related-party transactions that are large relative to other transactions;
- recurring losses or large swings in operating results not in line with the taxpayer's functional and risk profile; and/or
- use of intangibles in the business.

In the course of the TPC, IRAS may arrange for a site visit to understand more about the taxpayers' transfer pricing policies. In almost all cases, transfer pricing documentation will be requested by IRAS, with submission to be made within 30 days of the request.

### Adverse implications of non-compliance

TPG3 explicitly mentions several adverse implications for taxpayers that do not comply with the documentation requirements or the arm's-length principle.

Specifically, IRAS has the legislative power under Section 34D of the SITA to impose upward adjustments to the taxpayer's taxable profits. There may also be penalties for under-declaration of income tax. In addition, where transfer pricing documentation is not available, IRAS may not support the taxpayer in a Mutual Agreement Procedure to resolve double taxation, or may not accept the taxpayer's APA application.

IRAS has also indicated that it is monitoring taxpayers' compliance level and may consider more stringent measures where necessary – including the introduction of specific record-keeping regulations for transfer pricing.

### How companies are responding

With continual update of its transfer pricing guidance, IRAS hopes to foster greater transfer pricing compliance, not only through clarification of its expectations, but also through reminders of its audit programme and penalties for non-compliance. A centrepiece of the IRAS compliance requirements is adequate contemporaneous transfer pricing documentation.

Flowing from this, a substantial number of companies have embarked on projects to update or prepare their transfer pricing documentation. It is important for this document to be in place to mitigate transfer pricing exposure.

### How KPMG can help

At KPMG, we have assisted many companies in addressing transfer pricing issues by:

- **recommending** appropriate arm's-length transfer prices to value transactions for both documentation and planning purposes;
- **defending** against tax authorities' audits of transfer prices;
- **preparing** contemporaneous documentation;
- **negotiating** APAs with tax authorities to cover future transfer prices;
- **making** presentations on behalf of taxpayers during IRAS' Transfer Pricing Consultation process; and
- **assisting** in the identification and quantification of transfer pricing positions for mergers and acquisitions, FIN48, and corporate financial control purposes.

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