

6 THINGS TO KNOW ABOUT THE 6TH EDITION TRANSFER PRICING GUIDELINES

AUGUST 2021

On 10th August 2021, the Inland Revenue Authority of Singapore ("IRAS") released the long awaited 6th Edition Singapore Transfer Pricing Guidelines ("6th Ed TPG"), three years after the 5th Edition, and setting out significant new content.

1. No more beating around the bush

The Inland Revenue Authority of Singapore ("IRAS") has officially renamed "Transfer Pricing Consultation", a programme first introduced in 2008, to Transfer Pricing Audit ("TPA"). The 6th Ed TPG clearly states that a possible outcome of the TPA is an adjustment to taxable income under Section 34D of the Singapore Income Tax Act ("SITA"), should related party transactions be found to be conducted under non-arm's length conditions. The new chapter consolidates earlier guidance on the topic and IRAS has further clarified that they would not accept taxpayers' requests for advance pricing arrangements ("APAs") for any related party transactions undergoing audit or investigation.

BDO Insight:

The renaming is consistent with IRAS' increasingly firm hand and active efforts in the enforcement of Singapore's transfer pricing legislation. Already we see a recent increase in transfer pricing audit activity.

It is important to note that the enforcement does not just stop at compliance with the transfer pricing documentation ("TPG") requirement. Whilst most taxpayers have over the past six years (since the introduction of the 2nd TPG in 2015) complied and prepared the requisite TP documentation per the statutory requirements, it appears that the IRAS is now gearing up to review and challenge the robustness of the documentation prepared.

FOR MORE INFORMATION:

Scan this QR code to start a WhatsApp chat with BDO SG Transfer Pricing Team.



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2. Remission for good behaviour

Introduced in the 5th Ed TPG and legislated in the SITA in 2018, a surcharge of 5% applies on transfer pricing adjustments made by IRAS arising from a TPA, regardless of whether there is tax payable arising from the adjustments. The surcharge is similarly applied to taxpayers who volunteer self-initiated retrospective upward adjustments. The 6th TPG provides for a partial or full remission of the surcharge for taxpayers under these two scenarios, subject to certain conditions being met under each scenario.

Conditions for remission

- ▶ Under a TPA scenario:
 1. Taxpayer has been cooperative and provided required documentation within the timeline set by IRAS.
 2. Taxpayer has maintained proper transfer pricing documentation in accordance with Section 34F of the SITA and TP Documentation Rules.
 3. Taxpayer has a good compliance record of prompt submission of tax returns and payment of tax by the due dates for the current Year of Assessment (“YA”) and immediate two preceding YAs.
- ▶ Under a voluntary disclosure scenario, there are 2 additional conditions:
 1. Self-initiated retrospective upward adjustments are made within two years from the tax return filing due date
 2. Taxpayer has not received IRAS’ query relating to any related party transactions for the relevant YA; or has not received IRAS’ notification on the commencement of an audit or investigation

Who should consider self-initiated retrospective upward adjustments?

- ▶ Taxpayers who have historically not been remunerated or had been remunerated below arm’s length. For example, this may apply to:
 - Persistent loss-making companies which are captive service providers to the multinational group, or which are characterized as low or routine risk service providers/ distributors/ manufacturers.
 - Singapore headquartered holding companies which have not been charging out arm’s length fees for the management and support services rendered to its related parties.
- ▶ Taxpayers who might have in prior years taken aggressive or incorrect transfer pricing positions, and who now want to set things right by adjusting profits upwards, without suffering a surcharge.

BDO Insight:

The concept of extending a remission of penalty for good behaviour is not new, although only a handful of tax administrations have adopted this approach in the context of transfer pricing enforcement. Perhaps recognising the dilemma of taxpayers who are keen to “set things right” but do not want to incur the surcharge, we consider IRAS to be progressive in empowering taxpayers to actively manage their transfer pricing risks. In Asia, Thailand is the only other country affording such a relief.

For many taxpayers, transfer pricing documentation is often prepared on an ex-post basis (i.e. after the event) and it might then be too late for taxpayers to put through book entries to correct any incorrect transfer pricing positions taken in the specific year. Thus, we expect the provision of the remission to be warmly welcomed by many taxpayers. To maximize the benefits of the remission, affected taxpayers will want to put through their retrospective upward adjustments for prior years by the time of filing their YA 2021 tax return (since YA 2019 was the first year the surcharge was introduced).

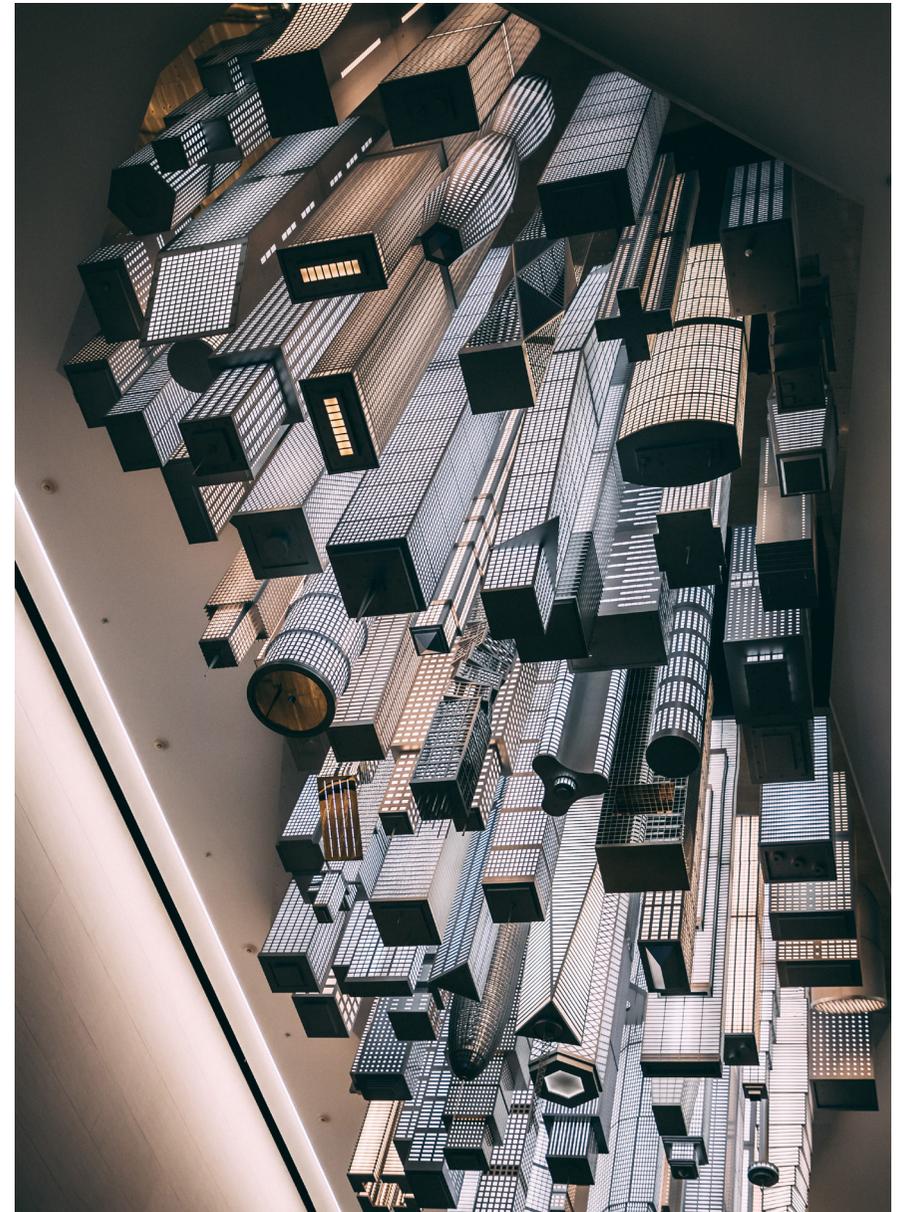
3. Focus on related party financial transactions

The 6th Ed TPG has dedicated 18 pages to the chapter on "related party financial transactions", in comparison to only 9 pages in the 5th Ed TPG on "related party loans". As the change in the name of the chapter suggests, the 6th Ed TPG covers guidance on the broader gamut of financial transactions including cash pools, financial guarantees, hedging and captive insurance instead on only focusing on "loans".

For the first time, the concept of 'quasi-equity' is discussed, providing guidance on characterisation of the purported loan between related parties, to determine whether the same could be considered as debt or equity and setting out criteria for delineating the features of the financial transaction. There is also more detailed guidance and examples on the application of different methodologies for pricing of financial transactions between related parties, including guidance on risk-free rates of return, centralized financial functions such as administering cash pools, analysis of credit rating of the borrower and the impact of implicit support on the borrower's credit rating.

BDO Insight:

The 6th edition TPG categorically states that the IRAS does not regard interest-free loans to be at arm's length, unless it can be established that unrelated parties under similar circumstances would provide loans without charging interest. This makes it critical for taxpayers to undertake early analysis of their related party financial transactions to determine the characterisation and prepare appropriate documentation to support their positions with suitable economic analysis.



4. More on related party services

The IRAS has a long established administrative practice of accepting 5% cost mark-up for certain routine support services (falling under Annex C of the TPG) without the need for taxpayers to prepare benchmarking studies. The 6th Ed TPG has now provided taxpayers another option to apply the 5% profit mark-up under the Organisation for Economic Cooperation and Development (“OECD”) simplified approach for low value-adding intra-group services (“OECD simplified approach”), subject to conditions, a main one being that the tax authority of the related counterparty must have also similarly adopted the OECD simplified approach.

The 6th Ed TPG also provided new guidance on shareholder activities (setting out examples and clarifying that these activities would not be regarded as related party services and should not be charged to any of the group members) as well as on the use of value-added cost mark-up as a profit level indicator for analysis under the TNMM (setting out strict criteria for its application, similar to the case of the berry ratio).

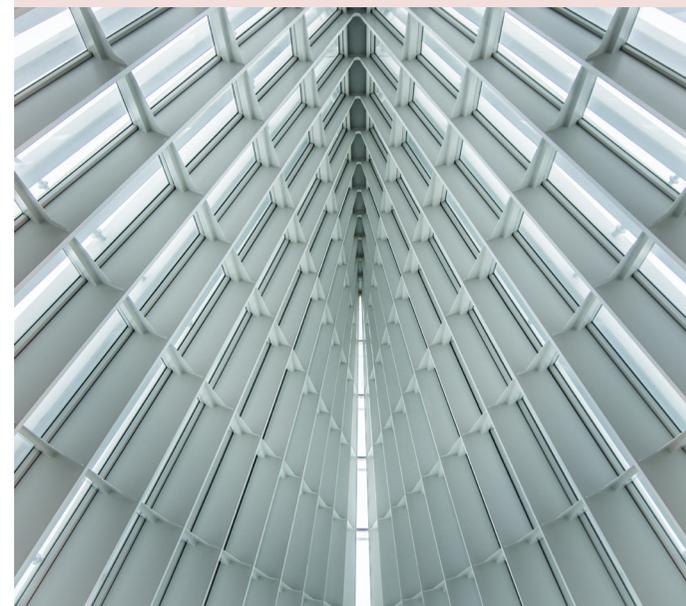
BDO Insight:

The list of services under IRAS’ administrative concession is restrictive and many related party services would not qualify for the 5% mark-up. The new option to rely on OECD’s simplified approach is much welcomed, as it would reduce some compliance efforts for taxpayers. That said, we note that where taxpayers engage in services such as services constituting the core business of the MNE group, research and development services, manufacturing and production services, sales, marketing and distribution activities, financial transactions, insurance and reinsurance, and services of corporate senior management (other than management supervision of services that qualify as low value-adding intra-group services), a robust benchmarking study would still be required to determine the arm’s length margin for the services.

Earlier this year, the IRAS had published a special topic transfer pricing guidance on centralized service activities of MNE Groups in Singapore. The 6th Ed TPG has further elaborated guidance on related party services, thereby affirming that related party service transactions remain a key focus area for IRAS.

List of countries which have adopted the OECD simplified approach:

- | | |
|-------------------|--------------------|
| 1. Australia | 12. Italy |
| 2. Austria | 13. Japan |
| 3. Belgium | 14. Korea |
| 4. Czech Republic | 15. Liechtenstein |
| 5. Denmark | 16. Lithuania |
| 6. Finland | 17. Netherlands |
| 7. France | 18. New Zealand |
| 8. Hungary | 19. Norway |
| 9. India | 20. Peru |
| 10. Ireland | 21. Switzerland |
| 11. Israel | 22. United Kingdom |



5. New on cost contribution arrangements

In further aligning with the OECD's Transfer Pricing Guidelines, IRAS has also included a section on cost contribution arrangements ("CCA") which echoes that mutual benefit is a fundamental concept to the CCA, requiring all participants to share in the overall contributions to a CCA, the associated risks, as well as the exploitation of profits. The 6th Ed TPG details guidance on applying the arm's length principle to two types of CCAs – Development CCAs and Services CCAs, specifically with respect to the entry, withdrawal, and termination stages of the CCA. IRAS has also highlighted the applicable deductibility and withholding tax treatments for balancing payments, and requirement for an application for mutual agreement procedure ("MAP"), should the taxpayer seek a transfer pricing adjustment which will result in an increase in its claim for deduction, or reduction in the tax previously withheld.

BDO Insight:

The introduction of this new section affirms IRAS' recognition of CCAs as being common global commercial arrangements. We observe the guidance comes on the heels of a recent Singapore high court tax case involving CCAs, and provides timely clarity on the applicable tax treatments from a Singapore tax perspective.

Where CCAs are common for US and Europe headquartered multinational companies, the endorsement of the CCA allows SG headquartered companies to similarly adopt CCA arrangements, which might be a solution for simplifying multiple inter-company transactions among group members. It is noted the wider applicability of CCAs in this new section, vis-à-vis the administrative concession under cost-pooling arrangements in the section on related party services (which are limited to only prescribed routine support services and subjected to stricter criteria).

6. Pulling expectations together

The 6th Ed TPG has included an appendix on frequently asked questions ("FAQs") relating to the preparation of TP documentation ("TPD"), including the importance of complete information as required under the TPD Rules and meeting the contemporaneous deadline by tax return filing dates. The IRAS clarifies that while taxpayers can leverage on TPD prepared at the group level or prepared for other tax authorities, they must be supplemented by local entity information and analysis, in order to meet Singapore transfer pricing requirements.

BDO Insight:

A key takeaway from the FAQs shared is IRAS' underlying expectation for taxpayers to prepare high quality and robust TPD, providing sufficient information on the business, supply chain and related party transactions to enable to IRAS to assess the arm's length nature of the taxpayer's dealings with its related parties. "Not all TPD is created equal" and it is important for taxpayers to put in place a solid first line of defense.



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