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Transfer pricing alert

Singapore updates key sections of its transfer pricing guidelines

On 14 June 2024, the Inland Revenue Authority of Singapore (IRAS) released the *Transfer Pricing Guidelines (TPG) (Seventh Edition)*. Compared to the sixth edition TPG, published on 10 August 2021, the seventh edition TPG provides updates and additional transfer pricing (TP) guidance in several areas. Singapore's transfer pricing documentation (TPD) rules have also been amended to reflect the changes in the seventh edition TPG[1].

The key changes in the seventh edition TPG and TPD rules include:

- Additional guidance on TP aspects for financial transactions
- Increased thresholds for exemption from TPD requirements for certain transactions from Year of Assessment (YA) 2026
- Dating of simplified TPD
- Guidance on working capital adjustments
- Additional guidance on the conditions around remission of the 5% surcharge
- Guidance on TP adjustments for capital transactions
- Additional guidance on strict pass-through costs
- Guidance on the TP aspects of government assistance
- Additional guidance on TP audits
- Removal of the pre-filing phase under the Mutual Agreement Procedure (MAP)
- Additional guidance on how the IRAS will disregard an actual related party transaction

[1] Income Tax (Transfer Pricing Documentation) (Amendment) Rules 2024, which came into effect on 10 June 2024.

Additional guidance on TP aspects for financial transactions

The TPD rules and seventh edition TPG exempt any related party domestic loan entered on or after 1 January 2025 from TP documentation if neither the lender nor the borrower is in the business of borrowing and lending and the IRAS indicative margin is applied[2].

This means that the IRAS will discontinue the practice of limiting lenders' interest deductions as a proxy for the arm's-length principle for any related party domestic loan entered on or after 1 January 2025[3]. For any related party domestic loan entered on or after 1 January 2025 (where neither party to the loan is in the business of borrowing and lending[4]), the parties to the loan may choose to either apply the IRAS indicative margin[5] to derive the interest rate or to determine the interest rate based on the arm's-length principle if the indicative margin is not applied[6].

In addition, the IRAS clarified that the requirement to review and refresh TPD annually applies to long-term related party loans. Nevertheless, taxpayers may consider preparing a simplified TPD if the conditions are met[7].

When transitioning from a related party Interbank offered rates based (IBOR-based[8]) loan to an alternate risk-free rate based (RFR-based) loan[9], taxpayers should include the following in the TPD:

- The basis of the changes and an explanation of how they are consistent with the IBOR reform, relevant guidance and the arm's-length principle.
- An explanation of whether a spread adjustment is necessary.
- The basis for determining the spread adjustment.

Where taxpayers made changes beyond those expected under the IBOR reform and relevant guidance, the IRAS will deem the taxpayers to have entered into a new loan. In that situation, taxpayers must establish the arm's-length terms and interest rate for the new loan and comply with the TPD requirements based on the seventh Edition TPG[10].

Taxpayers should review their existing related party financing arrangements (cross-border, domestic and IBOR-based loan transitions) and re-assess the arm's-length basis and TPD compliance status to comply with the new TP rules and guidelines. This is especially the case for IBOR-based loan transitions and domestic loans, where these changes could significantly affect the determination of the interest rates for related party loans (for domestic loans entered from 1 January 2025 onwards).

Increased thresholds for exempting certain transactions from TPD requirements from YA 2026

The thresholds for exemption from TPD for certain transactions (aside from the purchase and sale of goods or the provision or receipt of intercompany loans) increased from S$1million to S$2 million, effective from YA 2026 onwards[11].

The increase in the exemption thresholds is welcomed, as it relieves taxpayers from the administrative burden of TPD preparation. Taxpayers, however, should keep in mind that Singapore tax law still requires them to comply with the arm's-length principle for all related party transactions, regardless of the amount.

Dating of simplified TPD

The TPD rules and seventh edition TPG make clear that the contemporaneous TPD requirements apply similarly to simplified TPD. Therefore, to be considered contemporaneous, simplified TPD should also be completed by the tax filing due date and dated accordingly to prove its contemporaneous nature. The IRAS has also provided an example and clarifications through a frequently asked question (FAQ)[12].

Taxpayers using the simplified TPD provisions should take note of this to avoid non-compliance with the rules.

Guidance on working capital adjustments[13]

The seventh edition TPG clarifies that taxpayers can make working capital adjustments (generally for trade receivables, trade payables and inventory) to improve the reliability of the comparables analysis.

Such adjustments are made for interest rates, e.g., interest rates actually incurred, commercial lending rates or actual cost of funding.

The clarification largely aligns with the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TPG) on working capital adjustments (Annex to Chapter III), which is also referenced within the seventh edition TPG.

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[2] Section 6.18 (c) and 15.18, seventh edition TPG.
[3] Domestic intercompany loans entered before 1 January 2025 will continue to follow the interest restriction rule limiting the taxpayer's claim for any interest expense under section 15.16 of the sixth edition TPG.
[4] Section 15.15 provides examples of entities in the business of lending and borrowing and includes banks or other financial institutions, finance and treasury centers.
[5] The threshold of S$15million for purposes of the indicative margin does not apply for domestic loan.
[6] Section 6.18 (c) and 15.15, seventh edition TPG.
[7] Appendix B – FAQ 7, seventh edition TPG.
[8] Interbank offered rates (IBORs) such as LIBOR (London IBOR).
[9] Alternate risk-free rates (RFRs) such as Singapore Overnight Rate (SORA) for SG$ Swap Offer Rate (SOR) and SIBOR (SG$ IBOR).
[10] Section 15.58 and 15.59, seventh edition TPG.
[11] Section 6.18 (g), seventh edition TPG.
[12] Section 6.35 and Appendix B, FAQ 1, seventh edition TPG.
[13] Section 5.119 (FAQ), seventh edition TPG.

Additional guidance on conditions for reducing the 5% TP adjustments surcharge

Section 34E of the Income Tax Act 1947 (ITA) applies a 5% surcharge to the value of TP adjustments initiated by the IRAS if the IRAS does not consider the transactions to be at arm's length. The sixth edition TPG outlines certain conditions where the IRAS may fully or partially reduce the surcharge.

In the seventh edition TPG, the IRAS provided additional clarification on the condition of having "good compliance records" in the current YA and the two immediate preceding YAs, to include the requirement that taxpayers also have "no history of surcharges and penalties being imposed, remitted or compounded[14].

With the above clarification of the conditions for reducing surcharges, the IRAS continues to demonstrate its intent to be more stringent in driving higher levels of compliance with the arm's-length principle.

Guidance on TP adjustments for capital transactions[15]

The seventh edition TPG clarifies that TP adjustments would not apply to gain, loss or deductions from capital transactions that are not taxable or deductible under the ITA. No TPD is required for these transactions.

However, if the sale or transfer of fixed assets is not conducted at arm's length, the IRAS may apply the arm's-length principle to determine the allowance and balancing adjustment by following the specific provisions in the ITA (Sections 19B, 19D, 19E and 20).

In view of this ability, taxpayers should make certain that their transactions comply with the arm's-length principle if those transactions could potentially have income tax consequences.

Additional guidance on strict pass-through costs

The IRAS has clarified one of the conditions (condition (d)) for applying strict pass-through costs. This condition requires that the costs of the acquired services are the legal or contractual liabilities of the related parties benefiting from the services, as demonstrated by a written agreement with the related parties.

The seventh edition TPG allows the written agreement to include email correspondence between the group service provider and its related parties, be it a single email with all the related parties or separate emails with each related party[16].

Given the practical constraints of entering into legal agreements on items that are reimbursed on a cost basis, the change is a welcome clarification, one that shows the IRAS has adopted a more realistic approach towards administering strict pass-through costs.

Guidance on TP aspects of government assistance[17]

The seventh edition TPG includes a new section with guidance on determining how benefits from government assistance should be treated for TP purposes.

In general, government interventions would tend to be regarded as altering the conditions of the market in the corresponding jurisdiction and in turn affect the transfer price of a related party transaction.

The additional guidance aligns with previous guidance from the IRAS and provides insight on how the IRAS would consider (1) the receipt of government assistance in a related party transaction and (2) the relevant comparability analysis for arriving at the arm's-length price. It also illustrates how a comparability analysis should be conducted when government assistance is received.

Taxpayers are advised to maintain adequate TP analysis and documentation with the details of the government assistance in their TPD.

Additional guidance on TP audits

For the contemporaneous nature of information submitted as part of a TP audit, FAQ 8 of Appendix B of the seventh edition TPG clarifies that analysis conducted with hindsight generally will not be considered contemporaneous in nature[18].

In the sixth edition TPG, the IRAS indicated that taxpayers may make adjustments if they consider their taxable profit to be understated. In the seventh edition TPG, the IRAS expands this to include situations where they consider a loss to be overstated.

Further, the IRAS clarified that the 5% surcharge for non-compliance with the arm's length principle will apply once the adjustment is made (through a notice of assessment). Those objecting to the IRAS's adjustment must follow the IRAS's objection and appeal process to resolve the issue[19].

With this clarification, the IRAS has made clear that the domestic process for resolving TP disputes does not differ from the procedures for resolving disputes with the IRAS on other tax matters.

Removal of pre-filing phase under the MAP

The seventh edition TPG simplifies MAP by removing the steps related to the pre-filing phase; i.e., the notification of intent and pre-filing meeting[20].

This simplification is a welcome development given that MAP is a treaty obligation. It cuts down the time and resources required by the taxpayer in the MAP process and makes clear that the date of submission of the MAP application would be considered the date of notification for purposes of meeting the timeline specified in the relevant tax treaty for a MAP application.

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[14] Section 9.9, seventh edition TPG.
[15] Section 8.10 and 8.11, seventh Edition TPG.
[16] Section 14.22, seventh edition TPG.
[17] Section 18, seventh edition TPG.
[18] Appendix B – FAQ 8, seventh edition TPG.
[19] Section 7.10, seventh edition TPG.
[20] Section 11, seventh edition TPG.

Additional guidance on how the IRAS will disregard an actual related party transaction

The IRAS will disregard an actual related party transaction or replace it with an alternative transaction only in exceptional circumstances where:

- The arrangements made in relation to the transaction lack the commercial rationality that would be agreed between independent parties under comparable circumstances.
- The arrangements prevent determination of a price that would be acceptable to both of the parties, taking into account their respective perspectives and the options realistically available to them at the time they enter into the transaction [21].

In the example provided, the seventh edition TPG clarifies that the IRAS would not disregard income under a royalty agreement it considers commercially irrational if the recipient were a Singapore taxpayer. If the payer was a Singapore taxpayer, however, IRAS would disregard the royalty transaction for TP purposes and deny a deduction. In other words, the IRAS could still seek to tax the income even if arising from a transaction it considered commercially irrational.

Key considerations

The seventh edition TPG introduces changes to how the IRAS will consider intercompany pricing for intra-group funding. Taxpayers should review these carefully to examine how this would affect their intercompany financing TP policies and compliance going forward.

Throughout the seventh edition TPG, welcomed clarifications that guide taxpayers in assessing how to properly comply with the arm's length principle are observed. It is expected that IRAS will be stricter in their examinations around TPD adequacy and TP controversy.

[21] Section 8.8, seventh edition TPG.

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