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Singapore

Introduction

Although Singapore's income tax rates are traditionally lower than the income tax rates of the majority of Singapore's primary trading partners, the Inland Revenue Authority of Singapore (IRAS) is increasing its focus on transfer pricing issues.

Statutory rules

The Singapore Income Tax Act (SITA) contains provisions that may be used in a transfer pricing context to effectively allow IRAS to challenge and revise intercompany transactions. Further, the IRAS issued transfer pricing guidelines on 23 February 2006 to provide greater clarity on transfer pricing matters and procedures in Singapore.

Anti-avoidance

Section 33 of the SITA contains general anti-avoidance rules that allow IRAS to disregard or revise any arrangement in order to counteract a tax advantage obtained under an existing arrangement. The rules are applicable to any scheme, agreement or transaction as a whole, as well as the component steps by which the arrangement was carried into effect. The anti-avoidance rules do not apply if the arrangement is conducted for bona fide commercial reasons and the reduction or avoidance of tax is not one of its main purposes.

Related party transactions

Section 34D has been enacted recently in the SITA to legislatively endorse the arm's-length principle.

Section 53(2A) of the SITA applies where a resident and a non-resident are closely connected and conduct business in such a way that produces profits to the resident that are less than the ordinary profits that might be expected to arise in such transactions. In such a case, IRAS may assess and charge the non-resident tax in the name of the resident, as if the resident were an agent of the non-resident. Where the 'true' amount of the profit is not readily ascertainable, IRAS has the power to assess tax on a 'fair and reasonable' percentage of the turnover of the business done between the resident and the non-resident.

Tax authorities' powers

As a final measure, IRAS has the power to simply refuse to accept a tax return as filed and assess tax based on taxable income determined according to the best of its judgment.

Singapore transfer pricing guidelines

Background

The Singapore transfer pricing guidelines (the guidelines) were issued by the IRAS in February 2006. These guidelines provide guidance to Singapore taxpayers on application of the arm's-length principle and on documentation matters.

The said guidelines also provide the procedures for applying for the mutual agreement procedure (MAP) and advance pricing arrangement (APA) facilities, which are used to avoid or eliminate double taxation.

Scope

The guidance on application of the arm's-length principle is applicable to all related party transactions of goods, services and intangible properties. The guidance on MAPs and APAs are applicable only to related party transactions involving at least one party resident in Singapore or a jurisdiction with which Singapore has a comprehensive Double Taxation Avoidance Agreement. Further, the guidelines are applicable where at least one related party is subject to tax in Singapore.

Definition of related party

The guidelines define a related party for Singapore transfer pricing purposes as:

"The related party, in relation to any entity, means any other entity who directly or indirectly controls that entity or is controlled, directly or indirectly, by that entity, or where both entities, directly or indirectly, are under the common control of a common entity."

The arm's-length principle

The arm's-length principle described in the guidelines and legislated in the SITA is in line with the arm's-length principle in the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and Capital and in the OECD Transfer Pricing Guidelines (i.e. the arm's-length principle requires the transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent entity).

The guidelines, however, recognise that establishing and demonstrating compliance with the arm's-length principle requires exercise of judgment and recommends that taxpayers adopt a pragmatic approach to ascertaining arm's-length pricing for related party transactions.

The guidelines seek to provide guidance and recommendations on the application of the arm's-length principle with the following three-step approach:

Step 1 – Conduct a comparability analysis.

A comparability analysis is conducted to analyse whether the uncontrolled price/ margins being compared to the controlled price/margins have all economically relevant characteristics similar, such that one of the following conditions exists:

- None of the differences of the situations being compared can materially affect the prices or margins being compared.

- Reasonably accurate adjustments can be made to eliminate the effect of any such differences.

The guidelines also suggest that a comparability analysis should examine the comparability of the transactions in the following three aspects:

- Characteristics of goods, services and intangible properties.
- Analysis of functions, assets and risks.
- Commercial and economic circumstances.

The ultimate aim of the comparability analysis is a comprehensive assessment and identification of the areas and extent of significant similarities and differences (such as product characteristics or functions performed) between the transactions/entities in question and those to be benchmarked against.

Step 2 – Identify the appropriate transfer pricing method and tested party.

The guidelines indicate that, in theory, the traditional transaction methods provide for a more direct comparison with independent party transactions and hence would be superior to the transactional profit methods. However, the guidelines do recognise that, in practice, the reliability of the results produced by any method would be crucially affected by the availability and quality of data, as well as the accuracy with which adjustments can be made to achieve comparability. Hence, the guidelines do not have a specific preference for any one method. The guidelines recommend the adoption of the method that produces the most reliable results, taking into account the quality of available data and the degree of accuracy of adjustments.

The guidelines allow the Singapore taxpayer to select any one of the following methods for its transfer pricing purposes:

- Comparable uncontrolled price (CUP) method.
- Resale price method.
- Cost plus method.
- Profit split method.
- Transactional net margin method.

The guidelines also allow the taxpayer to use a modified version of one of these methods to comply with the arm's-length principle, as long as the taxpayer maintains and is prepared to provide sufficient documentation to demonstrate that its transfer prices are established in accordance with the arm's-length principle.

Step 3 – Determine the arm's-length results.

Once the appropriate transfer pricing method has been identified, the method is applied on the data of independent party transactions to arrive at the arm's-length result.

Documentation

The guidelines provide guidance on the type of documentation that taxpayers should keep in order to demonstrate that reasonable efforts have been taken to comply with the arm's-length principle.

The guidelines indicate that the following information (not exhaustive) would be useful in substantiating that the taxpayer's transfer pricing analyses are in accordance with the arm's-length principle and that the taxpayer has made reasonable efforts to determine arm's-length transfer prices, margins or allocations:

- General information on the group.
- Information on each related party in Singapore (Singapore entity).
- Details of transactions between Singapore entity and all related parties.
- Transfer pricing analysis.

However, the guidelines recognise that keeping robust documentation may result in compliance and administrative costs for taxpayers. In this respect, the guidelines indicate the following principles with regard to documentation:

- Taxpayers are only required to prepare or obtain documents necessary to allow a reasonable assessment of whether they have complied with the arm's-length principle.
- Singapore currently does not impose a penalty specifically for the lack or insufficiency of documentation. However, if the taxpayer violates the recordkeeping requirements under Sections 65, 65A and 65B of the SITA, the IRAS would not in any way be precluded from enforcing these relevant provisions.
- The IRAS does not require documentation to be submitted when the tax returns are filed. Taxpayers should keep the documentation and submit it to IRAS only when requested to do so.

Guidelines in connection with MAP

The guidelines also provide the IRAS' position on the MAP process as well as provide guidance on the manner in which taxpayers may apply for the MAP with respect to transfer pricing adjustments.

The MAP aims to provide an amicable way by which competent authorities may eliminate double taxation. Although IRAS would endeavour to eliminate or reduce the double taxation that the taxpayer may encounter, it is possible only if there is concurrence by all competent authorities involved in the process and full cooperation by the taxpayer.

The guidelines indicate that the IRAS generally accepts a taxpayer's request for MAP if:

- the taxpayer has complied with the time limit specified in the applicable double tax agreement (DTA) for presenting the MAP request
- double taxation is almost certain and not just a possibility, and
- the taxpayer is willing and able to render full cooperation.

Further, the guidelines also provide the procedural aspects involved in making a MAP request to IRAS. The procedure involves:

Step 1 – Submit notification of intention to make MAP request

The notification to IRAS should be made in writing and should describe briefly the circumstances and provide basic information concerning the cause of double taxation.

Step 2 – Hold preliminary meetings
In the preliminary meetings, the IRAS evaluates the taxpayer's situation and grounds for making the request as well as the quality and adequacy of the taxpayer's documentation.

Step 3 – Submit formal request
Unless the IRAS or other competent relevant authorities object to the taxpayer's MAP request, the taxpayer should formally submit a MAP request to the IRAS.

Step 4 – Review and resolve double taxation
IRAS commences the process of MAP and tries to resolve the double taxation issue with the other relevant competent authorities.

Step 5 – Hold post-agreement meeting and implement agreement
Upon reaching agreement with the other competent authority, the IRAS meets with the taxpayer to discuss the details of the agreement and to implement the agreement.

Guidelines in connection with APA
An APA determines, in advance, an appropriate set of criteria to ascertain the transfer prices of specified related party transactions over a specified period of time. The treaty provisions and the domestic tax provisions enable Singapore competent authorities to accede to requests from taxpayers for APAs and enter into such agreements. Singapore allows for unilateral as well as bilateral APAs.

IRAS has issued additional guidance for taxpayers seeking to enter into unilateral, bilateral or multilateral APAs. This supplementary administrative guidance on APAs sets out various important time lines to observe during preliminary meetings, the formal APA submission and review, and when (and the period for which) roll-back may apply to bilateral or multilateral APAs. The guidance also spells out the circumstances under which the IRAS will discontinue an APA discussion. Broadly, the process involves:

Step 1 – Hold preliminary meetings
Generally, at preliminary meetings, the taxpayer is expected to present the salient information such as the company's business model and industry information, transactions to be covered, the period of APA, etc. The first preliminary meeting with the IRAS should take place at least three months before the date the taxpayer intends to submit an APA application to the IRAS and/or another competent authority. The IRAS discourages anonymous requests to discuss potential APAs. If the IRAS is willing to accept the APA, it advises the taxpayer on the appropriate follow-up action.

Step 2 – Submit formal APA
Unless the IRAS or relevant foreign competent authorities disagree, the taxpayer should formally submit an APA request at least six months before the first day of the proposed APA covered period.

Step 3 – Review and negotiate APA
Within one month of receipt of the formal application, the IRAS informs the taxpayer of whether the APA application has been accepted or rejected. The taxpayer should note that the IRAS reserves the right to propose alternative methodologies or to request a restriction or expansion of the scope of the proposed APA subsequent to the formal submission of the APA application. If the IRAS accepts the APA application, it

begins the process of seeking an APA with relevant foreign competent authorities (in case it is a bilateral or multilateral APA).

Step 4 – Hold post-agreement meeting and implement APA
Upon reaching agreement, the IRAS meets with the taxpayer to discuss the details of the agreement and to implement the agreement.

Other regulations
The IRAS releases interpretation and practice notes as well as administrative statements to provide guidance to taxpayers on a variety of issues. These publications do not have the force of law and are not binding. However, they do provide the IRAS' view on the law and its administrative practices in its application of the law.

Legal cases
To date, no specific cases relating to transfer pricing issues have been brought before a Singapore court. However, case law from other common law jurisdictions may be applicable on a case-by-case basis.

Burden of proof
It is common for the IRAS to query the basis of inter-company charges or transactions by requesting that a taxpayer provide evidence that such transactions are at arm's length. The burden of proof lies with the taxpayer.

Tax audit procedures
Pursuant to the transfer pricing consultation circular issued by IRAS in July 2008, a questionnaire requesting information on related party transactions is sent to selected taxpayers. The objective of the transfer pricing consultation is to assess the level of compliance with the Singapore transfer pricing guidelines by reviewing the taxpayer's transfer pricing documentation. This questionnaire is, in effect, a declaration that the taxpayer must sign. Based on the response to the questionnaire, taxpayers may be selected for an in-depth field visit and further examination by the IRAS if their transfer pricing practices are found to be inappropriate.

Additionally, to determine the accuracy of a tax return, the IRAS may require any taxpayer to provide their books, documents, accounts, returns and any other information that would allow the IRAS to obtain full information in respect of the taxpayer's income. Business records are required to be maintained for at least five years.

Revised assessments and the appeals procedure
If the IRAS does not agree with a taxpayer's tax return, it may, within six years after the year of assessment (for year of assessment 2007 and earlier) and four years after the year of assessment (for year of assessment 2008 and thereafter), issue a notice of assessment based on its 'best judgment'. A taxpayer that disagrees with a notice of assessment must object in writing within 30 days from the date of the notice. As the taxpayer is required to provide detailed grounds for objection, documentation to support its inter-company pricing should be available at this time. The IRAS considers the grounds for the objection, including any documentation received, and may issue an amended assessment. If the IRAS and the taxpayer are unable to reach an agreement, a 'Notice of Refusal to Amend' is issued.

Taxpayers have the right to appeal to the Board of Review if they are dissatisfied with the IRAS' decision. Based on the decision of the Board of Review, the taxpayer or the IRAS may choose to appeal to the High Court. Subsequently, application may be made to the Court of Appeal if either party is dissatisfied with the High Court's decision. However, the Court of Appeal does not hear appeals on a question of fact.

Additional tax and penalties

The legislation and the transfer pricing guidelines do not provide penalties specifically directed at transfer pricing 'offences'. However, the general provisions relating to offences and penalties are applicable where the IRAS has a dispute with a taxpayer in relation to its inter-company transactions.

A taxpayer that omits or understates any income may be subject to a penalty equal to the amount of tax that has been or would have been undercharged. Where a taxpayer is found to be negligent in omitting or understating income, the penalty is double the amount of tax that has been undercharged plus a fine not to exceed 5,000 Singapore dollars (SGD), or imprisonment for a term not to exceed three years, or both. A taxpayer who is found to have wilfully understated their income with intent to evade tax is subject to more severe penalties.

Further, IRAS can invoke penalty provisions under Sections 65, 65A and 65B of the SITA for violation of record- or information-keeping requirements; can impose a fine not to exceed SGD 1,000; and, in default of payment of fine, can impose imprisonment for a term not to exceed six months.

Penalties and interest charges on the underpayment of tax are not deductible for tax purposes.

Resources available to the tax authorities

The IRAS has obtained training on transfer pricing from other tax authorities and shares information on a regular basis with other Association of South East Asian Nations (ASEAN) tax jurisdictions in relation to the taxpayers.

Use and availability of comparable information

Although Singapore does not mandate contemporaneous documentation requirements, it requires taxpayers under review to verify and confirm the arm's-length nature of its related party transactions through sufficiently detailed and comprehensive documentation. The documentation should include an analysis of the functions and risks undertaken by the Singaporean taxpayer and the methodology upon which it derived the transfer price, including benchmarking.

Availability

The IRAS requires transfer prices to be comparable to industry standards. Comparable information is available through databases.

Limitation of double taxation and competent authority proceedings

In addition to the limited agreements dealing with the taxation of the international traffic of ships and aircraft, Singapore has a fairly extensive network of comprehensive double tax agreements modelled based on the OECD convention.

The majority of Singapore's treaties contain an 'Associated Enterprises' article which permits the respective tax authorities to adjust the profits of an entity where the transaction did not occur at an arm's-length price. However, very few of its treaties contain the accompanying relieving provisions in the article that effectively requires one country to reduce the amount of tax charged to offset the increased tax liability imposed by the other country as a result of reflecting the transaction at arm's length.

Where a treaty does not contain the relieving provisions, a taxpayer must apply to the competent authorities under the mutual agreement procedure (MAP) article to obtain relief from double taxation. See the Statutory rules section for details relating to this process.

Advance pricing agreements

The treaty provisions and the domestic tax provisions enable Singapore's competent authorities to accede requests from taxpayers for advance pricing agreements (APAs) and enter into such agreements. See the Statutory rules section for details relating to this process.

Funding

The IRAS has released transfer pricing guidelines on application of the arm's-length principle to related party loans. Domestic and cross-border loans are covered under this guideline.

The taxpayer should adopt the arm's-length methodology in related party cross-border loans. As time is needed to restructure loans to reflect an arm's-length rate of interest, the IRAS provides a transitional period of two years starting from 1 January 2009. From 1 January 2011 onwards, IRAS requires all related party cross-border loan arrangements to reflect arm's-length conditions.

Management services

A number of entities have been set up in Singapore to provide services to related parties in the region. Transfer prices for such services are typically determined on a cost plus basis. In the past, IRAS generally accepted the transfer price for management services where the service actually performed for the benefit of the payer can be identified and the transfer price reflects at least a 5% profit on the total cost of the service. Note that IRAS has now issued guidelines on related party services, which states that a 5% profit is accepted for only routine services. The IRAS would expect a higher profit in the case of greater value-added services provided by a Singaporean entity, for example, research and development.

Where a non-resident related party provides management services to a Singaporean entity, the fee charged to the Singaporean entity is generally deductible if the services provided can be identified and the fee is reasonable and appropriate, based on the costs actually incurred by the service provider. Further, there must be a direct benefit to the Singaporean entity to receive a deduction. No Singaporean withholding tax is levied on the payments made by Singaporean entities where services are rendered outside Singapore.

The IRAS is increasingly scrutinising intragroup recharges to ascertain that services have provided a direct benefit to the Singaporean entity. Taxpayers are required to

justify the level of service received vis-à-vis the recharge and confirm that the recharges exclude any shareholder costs.

IRAS has also issued guidelines on the conditions where cost pooling or pass-through costs are acceptable.

Business profits

Singapore's comprehensive double tax agreements contain a 'Business Profits' article that provides, in general, that business profits of an enterprise are not taxable in Singapore unless that enterprise has a permanent establishment (PE) in Singapore. Where an enterprise has a PE in Singapore, only those profits attributable to that PE may be taxed in Singapore.