

## The 7<sup>th</sup> edition of the Transfer Pricing Guidelines

On Friday 14 June 2024, the Inland Revenue Authority of Singapore ("IRAS") released the 7<sup>th</sup> edition of the Transfer Pricing Guidelines ("TPG"), which is updated from the last edition released 10 August 2021.

In doing so, IRAS has clarified its position in relation to financing transactions, capital transactions, economic analyses and a range of other transfer pricing ("TP") topics (Transfer Pricing Documentation, "TPD"), audits and surcharges.

### Certain guidance remains the same as for the 6<sup>th</sup> edition of the TPG

The following remain unchanged from the previous edition of the TPG:

- › all taxpayers (large or small), are required to apply the arm's length principle to ensure that the pricing of their transactions with related parties ("RP") reflects independent pricing;
- › taxpayers are to prepare and keep contemporaneous TPD on meeting SGD 10M revenues in a basis period, or where TPD is required to be prepared in the prior tax basis period, to evidence that RP transactions are conducted at arm's length;
- › the TPD needs to be prepared by the income tax return filing date for the tax period and retained for five years;
- › while details of the TPD remain accurate and relevant (with no material changes year-on-year), taxpayers may refresh their TPD once every three years and prepare simplified TPD in between years, if conditions are met; and
- › the penalty for non-compliance is a fine not exceeding S \$10,000

### Differences in the 7<sup>th</sup> edition of the TPG

The following summarises the main differences with the updated 7<sup>th</sup> edition of the TPG:

#### 1. Financing Transactions

- › **New rules regarding the exemption of TPD preparation apply to domestic RP loans, where:**
  - › Taxpayers enter into RP loans (as defined in para 15.6) for any amount, on or after 1 January 2025, where (i) neither the lender nor borrower is in the business of lending and borrowing money, and (ii) the IRAS indicative margin is applied in accordance with the administrative practice in TPG paras 16.60 to 15.69.
  - › Additionally, if the Taxpayers choose not to apply the IRAS indicative margin, they will apply the arm's length methodology to determine the interest rate as in TPG para 15.19.
- › **Inclusion of Frequently Asked Questions (FAQ) and TPD guidance for long term loans:**
  - › In Appendix B of the 7<sup>th</sup> edition of the TPG, IRAS updated its guidance (as FAQs) to clarify its position on:
    - (i) whether to prepare TPD annually for long term loans; and
    - (ii) whether the submission of information in later years to address audits in earlier years, is contemporaneous; and
    - (iii) whether taxpayers should review and refresh TPD annually for long term RP loans, IRAS views the requirement as no different than that for other RP transactions:

- › The facts and circumstances of a long term loan may change with time (e.g., economic environment, collateral value, credit standing) and impact the interest rate, T's & C's, or change to an equity arrangement.
- › Conducting an annual review confirms that no material changes have occurred in the tax basis period and if the conditions are met, simplified TPD may be prepared to ease the compliance burden.
- › **Guidance on the base reference rates:**
  - › In sections 15.40 -15.47 of the 7<sup>th</sup> edition of the TPG, IRAS provides guidance on identifying a suitable base reference rate in the determination of a loan interest rate, based on consideration of relevant economic characteristics of the RP loan.
  - › The IRAS guidance for base reference rates includes:
    - (i) the replacement of interbank offered rates ("IBOR"s) as a base loan reference rate with risk-free rates ("RFR");
    - (ii) the transition from existing loan interest rates referenced to IBOR, to rates referenced to RFR at arm's length, by applying relevant guidance from governing bodies and where appropriate, a spread adjustment to account for the economic difference between RFR and IBOR reference rates; and
    - (iii) for changes beyond those attributable to the IBOR reform and relevant guidance, IRAS may consider loan re-financing.
  - › TPD prepared to support loan interest rates, should include:
    - (i) the basis change and proof of consistency with IBOR for intercompany loan transactions, and guidance and arm's length principal (for a loan transition); or
    - (ii) the RFR base rate, an explanation as to whether a spread adjustment is necessary, and the basis of a spread adjustment (for a new loan).

## 2. Capital transactions:

- › **Clarifications in IRAS's views on the transfer/sale of fixed assets between RPs, including the use of open market price for the transfers/sales:**
  - › A gain, loss or deduction arising from a capital transaction is not taxable or deductible under the ITA – and no TPD for the transactions is required;
  - › Under the "Transfer Pricing Adjustments by IRAS" section in the 7<sup>th</sup> edition of the TPG, IRAS clarifies that where a sale or transfer of fixed assets between RPs is not conducted at arm's length, IRAS may apply the arm's length principle to determine the allowance and balancing adjustment, it will apply ITA provisions on use of the open-market price to determine:
    - (i) the allowance when the capital expenditure incurred in acquiring the fixed assets exceeds the open-market price; and
    - (ii) the balancing adjustment when the proceeds for the sale, transfer or assignment of the fixed assets is less than the open-market price.
- › **Documentation not mandatory (but preferred)**
  - › The taxpayers are not required to prepare TPD for such fixed assets for Singapore tax purposes; and
  - › However, as the open-market price will be used for tax purposes, TPD is preferred.

### **3. Economic analysis:**

- › **Guidance on how working capital ("WC") adjustments could be made (interest rates to be used, etc.):**
  - › The 7<sup>th</sup> Edition of the TPG guides that WC changes are typically applied to trade receivables, inventory and trade payables for comparable, to account for WC differences between tested and independent parties;
  - › While most often applied for TNMM searches, WC adjustments may apply for Resale Price or Cost Plus method searches, to improve the reliability of comparables – if they can be reasonably accurately applied;
  - › For WC adjustments, the appropriate interest rate is the rate applicable to a commercial enterprise operating in the tested party's market – in most cases, a commercial loan rate will suffice. Examples may include:
    - (i) Interest rate actually incurred by the tested party;
    - (ii) Interest rates from banks, bond yields, industrial yield curves or International Monetary Fund ("IMF");
    - (iii) Interest rate based on an appropriate base rate plus margin; and
    - (iv) As confirmation that the rate is applicable in the same market as the tested party, taxpayers may compare it to the tested party's actual cost of funding.
- › **Guidance on strict pass through costs:**
  - › In the 7<sup>th</sup> edition of the TPG, IRAS clarifies that a group service provider may pass on the costs of acquired services to its RPs without a mark-up where four conditions are met:
    - (i) The acquired services are for the benefit of the RPs;
    - (ii) The acquired services have been charged at arm's length;
    - (iii) The group service provider is simply a paying agent and does not enhance the value of the acquired services; and
    - (iv) The costs of acquired services are the legal or contractual liability of the group service provider or otherwise where the group service provider is legally or contractually liable for services payment as evidenced by an intercompany agreement or email correspondence stating the same), with its RPs for their assumption of the service liabilities.
  - › The TPG provides three examples to clarify the application of pass through costs, based on facts and circumstances, for procurement of corporate secretarial services, travel-related services, or licenses, on behalf of RPs.
  - › Where the services are provided according to the conditions above, the costs are strictly passed through to the RPs. However, in the license example, if the group service provider acquires software licenses to allow it to render IT services to the group, the license costs do not qualify for pass-through treatment – and will instead form part of the cost pool for the provision of IT services by the group service provider.
  - › Additionally, the group service provider costs in arranging, selecting and acquiring the services may be charged, subject to an arm's length mark-up.
- › **Treatment of government assistance for TP purposes:**
  - › A new section of the TPG outlines the provision of government assistance to a taxpayer, and where a benefit is received, its treatment for TP purposes;

- › The considerations include:
  - (i) whether the assistance had an impact on independent parties in the same market;
  - (ii) whether assistance forms part of the economic context in which an entity operates and impacts the TP analysis, and
  - (iii) whether it is economically relevant to independent parties.
- › What are the main messages?
  - (i) Government interventions may alter market conditions and receipt of assistance may form part of the economic circumstances of the parties and become a feature of the market;
  - (ii) However, mere receipt of assistance by one party may not affect the price of an accurately delineated RP transaction. Therefore in their comparability analysis, taxpayers should include an analysis of how receipt of government assistance affects the price of independent-party transactions, considering both parties' perspectives.
  - (iii) The receipt of government assistance by a party would not change the allocation of risk in the transaction for TP purposes, but may reduce the quantitative negative impact of materialization of risk.
- › IRAS provides three illustrations:
  - (i) a company in an RP transaction (B) partially fulfils its obligations to its counterparty (A), with wage subsidy government assistance proceeds;
  - (ii) an LRD which makes sales of goods to its RPs, receives a wage subsidy from the Singapore Government. The LRD should consider whether the wage subsidy is economically relevant to the transaction, whether the effect of the wage subsidy is passed onto customers, and whether adjustments to comparables are necessary to account for the wage subsidy; and
  - (iii) Recognising that challenges exist in performing the accounting analysis, IRAS notes that an independent party acting in a commercially rational manner would retain the benefits from the government assistance.

In Illustration 3, a Singapore contract manufacturer receives a wage subsidy from the government. Without details on how comparable manufacturers treat the wage subsidy, the Singapore contract manufacturer can argue that unrelated manufacturers would retain the benefits of government assistance.

#### **4. Audits, surcharges, TPD and other changes:**

- › **Further elaboration on the TP audit process:**
  - › In the 7<sup>th</sup> edition of the TPG, IRAS confirms the TP audit process as follows:
    - (i) starts with a first meeting with the taxpayer, including a presentation of an overview of the taxpayer's business, transactions and transfer pricing;
    - (ii) the process may involve subsequent meetings and information requests before IRAS assesses whether the taxpayer TPD is sufficient and whether any TP issues exist;
    - (iii) IRAS considers making an adjustment under Section 34D of the ITA (based on understated profits or overstated losses from incorrect TP) and will apply a surcharge under Section 34E;
    - (iv) if the taxpayer disagrees with the adjustment, they may object following the IRAS Objection and Appeal Process to resolve the issue with IRAS; and
    - (v) IRAS will close the audit with a letter on the appropriateness of taxpayer TP, TPD and any adjustment under Section 34D of the ITA, including any recommended improvements.

- › **Elaboration on how IRAS will disregard an actual RP transaction:**
  - › In the 7<sup>th</sup> edition of the TPG, IRAS elaborates on when it will disregard actual RP transactions. For example, IRAS does not disregard a transaction because it may not be seen between independent parties without considering if it is an arm's length arrangement.
  - › Rather, IRAS disregards or replaces actual RP transactions in exceptional circumstances, where the arrangement:
    - (i) Lacks commercial rationality that would be agreed between independent parties; and
    - (ii) Prevents determination of a price acceptable to both parties, accounting for their perspectives and options realistically available to the parties on entering into the transaction.
  - › In the example provided, Company A in Country A has entered into a royalty agreement for know-how with its RP, Company B in Country B – who pays Company A an annual royalty of \$X:
    - (i) If the know-how is publicly available, then Company B has entered into a commercially irrational transaction that independent parties would not pay for. There is no price acceptable to parties;
    - (ii) If Company A is in Singapore, IRAS will not disregard Company A's royalty income, in the absence of an APA or MAP with Country B; and
    - (iii) If Company B is in Singapore, IRAS will disregard Company B's transaction for TP purposes and treat the royalty payment as not deductible. IRAS would not replace the transaction with an alternative one since no independent parties would pay to use the know-how.
  - › Should the actual RP transaction be replaced by an alternative transaction, the replacement structure is guided by the facts and circumstances, to achieve a commercially rational arm's length result.
- › **Clarification on partial or full remission of S34E surcharges:**
  - › TP adjustments are subject to a surcharge of 5%, although the Comptroller may remit the surcharge wholly or in part.
  - › In the 7<sup>th</sup> edition of the TPG, IRAS will consider partial or full surcharge remission if taxpayers are cooperative during a TP Audit or review and have a good compliance record - requiring the taxpayer to:
    - (i) Be cooperative and provide responses and required documentation within the timeline set by IRAS;
    - (ii) Maintain proper TPD aligned with ITA Section 34F and TPD Rules; and
    - (iii) Have good a compliance record for the current YA and immediate two preceding YAs including prompt submission of tax returns and payment of taxes by due dates; and no history of surcharges and penalties imposed or remitted/compounded.
  - › A full surcharge remission is granted to taxpayers who voluntarily disclose non-arm's length RP transactions and make self-initiated retrospective upward adjustments provided:
    - (i) The adjustments are made within two years from the tax return filing due date; and
    - (ii) Taxpayers have not received any IRAS' query or notification on the commencement of an audit relating to any RP.

- › **Increase of thresholds and clarifications on how transaction categories should be aggregated:**
  - › Taxpayers are exempt from including documentation for certain RP transactions in the TPD when the transactions in the basis period fail to meet the stated threshold values. In the 2024 TPG, the thresholds have been revisited and increased, reducing the burden of proof in preparing TPD.  
Briefly:
    - (i) For the purchase or sale of goods between RPs and loans granted among RPs, the S \$15M threshold still applies;
    - (ii) For most other RP transactions, including broadly provision of services, granting of use rights for movable property, lease of property, grant of a guarantee or any other transaction, the threshold for exemption of TPD has increased from S \$1M to S \$2M.
  - › IRAS confirms that the RP transaction categories subject to the thresholds are aggregated by the total value of all transactions in the category, in the basis period.
- › **Date requirement for simplified TPD:**
  - › Taxpayers may use qualifying past TPD, for RP transactions in a basis period, preparing simplified TPD with a declaration by the taxpayer that it has prepared qualifying past TPD and including the past TPD in the simplified TPD;
  - › The 7<sup>th</sup> edition of the TPG (in section 6.35), guides that the simplified TPD must be prepared on a contemporaneous basis and dated – as proof that the simplified TPD has been prepared contemporaneously; and
  - › In the example provided, the YA 2024 tax return is due 30/11/24. The taxpayer prepared a simplified TPD for Y/E 31/12/23 on 1 October 2024 – which contained a declaration dated 1 October 2024 and a copy of qualifying past TPD (for FY 31/12/22, which was prepared on 15/11/23)

The new TP Guidelines reflects an easing of the compliance burden for taxpayers, whose related party transactions fall below the newly increased thresholds for transfer pricing documentation preparation. However, if your company has related party financing transactions, a transfer or sale of fixed assets, or if you have received government assistance, then you may well be impacted by the changes in the TP Guidelines.

At Taxise Asia, we specialise in providing transfer pricing advisory and compliance services and we guide our customers on meeting their obligations regarding related party transactions in Singapore.

If you have questions about whether your business is impacted by the changes in the 7<sup>th</sup> edition of the Singapore TPG, we are able to assist – both in answering your questions and in meeting your TP documentation requirements.

Please reach out for a discussion.

## Contacts

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### About WTS Taxise

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