Introduction of TP Penalties

The cost of non-compliance for transfer pricing (TP) in Singapore has recently increased tenfold, and maybe more, under the newly introduced formal legislation mandating the preparation of contemporaneous transfer pricing documentation. The changes mark the beginning of a formal, legislation-based transfer pricing regime, and is part of the increasing emphasis the Singapore tax authorities place on transfer pricing compliance.

1. Introduction

Internationalization and the expansion of businesses into overseas jurisdictions beyond their domestic borders in recent years has brought about an intensified focus on TP, and rightly so, as companies are able to exploit related-party transactions to manipulate taxable income reported in their various countries of operations. Where the pricing of related-party transactions is not executed in line with the arm’s length principle, tax authorities have the power to make adjustments and simultaneously impose interest and penalties, resulting in increasing costs for non-TP compliant companies.

In Singapore, the IRAS also endorses the arm’s length principle as the standard guide to TP, and subscribes to the principle that profits should be taxed where the real economic activities generating the profits are performed and where value is created. Singapore’s TP regime has seen substantial development since 2015, in line with the OECD’s Base Erosion and Profit Shifting (BEPS) Project, with yearly updates to the Singapore TP guidelines. In spite of this, Singapore did not administer a strict penalty regime in respect of TP non-compliance, with no specific penalties for the failure to prepare, maintain, retain or submit adequate TP documentation (TPD). Penalties for these offences were subject to the general offence penalty under section 94(2) of the Singapore Income Tax Act (SITA), which stipulates a fine not exceeding SGD 1,000 or an imprisonment for a term not exceeding 6 months in lieu of payment. These penalties may be considered minor and are also seldom administered in practice.

In lieu of the recent TP developments, formal penalties and surcharges have now been introduced in the Income Tax (Amendment) Bill 2017 as part of a major legislative change passed in Parliament on 26 October 2017. On 23 February 2018, the Income Tax (Transfer Pricing Documentation) Rules 2018 (the Rules) were gazetted and the Inland Revenue Authority of Singapore (IRAS) concurrently issued the fifth edition of the Singapore TP Guidelines, detailing the changes introduced in the new legislation and the Rules.

2. Penalties Relating to Transfer Pricing Documentation Offences

Alongside the requirement for taxpayers to prepare mandatory contemporaneous TPD under the newly legislated section 34F of the SITA, a specific fine of up to SGD 10,000 is now also imposed with effect from the year of assessment (YA) 2019 (i.e. financial year ended 2018) for each of the following legislated offences:

- failure to prepare or maintain TPD based on the requirements under section 34F;
- failure to prepare TPD by the time of making of the tax return;
- failure to retain TPD for a period of 5 years from the end of the basis period of the covered transaction;
- failure to submit TPD within 30 days from a request by the IRAS; or
- providing any documentation or information that the taxpayer knows to be false or misleading.

Taxpayers who commit any of the above-mentioned offences could be viewed as errant and non-compliant. Such taxpayers may also be at an increased risk of TP adjustments made by the IRAS as well as face potential rejection of mutual agreement procedures/advanced pricing applications with the IRAS.

The newly minted TP penalties and the shift from the imposition of a minor fine of SGD 1,000 to a full enforcement of penalties may hardly come as a surprise, given the recent spotlight on TP-related cases with the shift towards international trade and the resulting increase in cross-border transactions within multinational groups.

These legislations also reinforce Singapore’s commitment in its adoption of the OECD BEPS minimum standards, one of which is Action 13 on transfer pricing documentation. Action 13’s three-tiered, standardized approach to TPD comprising the CbC report, a Master File and Local Files, which require taxpayers to articulate consistent TP positions and are important for tax authorities for the assessment of TP risks. While Singapore currently does not adopt the Master/Local File format for TPD, it still requires an expanded list of group level information to be included in the local TPD. The penalties imposed for TPD offences represents Singapore’s stance in taking TPD and its compliance seriously.

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1. SG: Singapore Income Tax Act
3. Penalties Relating to Non-Compliance of the Arm’s Length Principle

With effect from YA 2019, a surcharge on TP adjustments made by the IRAS under section 34D of the SITA is now also legislated in section 34E, and appears to be in line with the more stringent TP penalties introduced. This surcharge represents 5% of the amount of increase in income or reduction in deduction/allowance/loss to be imposed on the taxpayer arising from the said TP adjustments.

Section 34D of the SITA empowers the IRAS to make a tax adjustment if the taxpayer’s taxable profit is understated due to non-arm’s length related-party transactions. With effect from 26 October 2017, section 34D was significantly expanded:
- to provide clarity on the powers of the Comptroller of Income Tax (the Comptroller) to disregard the form of actual commercial or financial relations between related parties where the substance of the transaction is inconsistent with the form of the transaction and for the Comptroller to make necessary adjustments; and
- to treat any amount of income increased under section 34D as accruing in or derived from Singapore or received in Singapore from outside Singapore, as the case may be.

Where the pricing of related-party transactions is not at arm’s length and results in a reduced profit for the taxpayer, the IRAS may perform a TP adjustment to adjust the profit of the Singapore taxpayer upward. The Comptroller is empowered to implement the relevant TP adjustments if these result in an additional tax liability on the taxpayers. However, downward adjustments which provide taxpayers with a reduction in income or an increase in deductions/allowances/losses were not addressed under the new Rules. In addition, the additional income arising from the TP adjustment will be deemed as sourced or received in Singapore. This may result in Singapore taxation of such adjustments in respect of foreign-sourced income that are not (deemed) remitted to Singapore (such as interest income on cross-border loans).

In cases where a TP adjustment is effected, a surcharge of 5% of the amount of increase in income or reduction in deduction/allowance or loss under the new section 34E will also be applied on top of the adjustments made by the Comptroller. It is payable within 1 month starting from the date of notice of surcharge, and applicable whether or not any additional tax is payable arising from the adjustments. This implies that such surcharges on the amount of TP adjustments will still be imposed and payable even in situations where the taxpayer has unabsorbed tax losses or allowances or is exempt from income tax under a tax holiday, e.g. where a taxpayer enjoys the Pioneer incentive under the Economic Development Board.

The surcharge on TP adjustments adopted by the Comptroller effectively equates to a penalty applied on such adjustments to derive the arm’s length pricing. In comparison with other tax jurisdictions where penalty protection on TP adjustments may be provided if the taxpayer is able to produce contemporaneous TPD, Singapore’s stance may appear to be more stringent given that the surcharge may be imposed whether or not supporting TPD is available (for example in cases where taxpayers are exempt from preparing TPD).

The shift in the Singapore TP penalty regime and, in particular, the introduction of the surcharge on TP adjustments represents a proactive step to ensure that Singapore taxpayers adhere to the arm’s length principle in their cross-border transactions. This is despite its status as a relatively low-tax jurisdiction, which generally attracts profit shifting within multinational groups to Singapore. With the increased scrutiny of foreign tax authorities on activities performed by a multinational group in such low-tax jurisdictions, it is paramount that Singapore advocates its support of the arm’s length principle as a fundamental guideline for transfer prices by enforcing stricter penalties governing TP documentation and adjustments.

4. Other Applicable Penalties

With effect from the YA 2018 (i.e. financial year ended 2017), taxpayers with related-party transaction values above SGD 15 million as disclosed in their audited accounts are also required to file a related-party transactions reporting form together with the submission of their income tax return by the filing deadline (i.e. 30 November 2018 for the YA 2018). The said form is considered as part of taxpayers’ income tax returns (i.e. Form C). This means that taxpayers who fail to file the form may be imposed a penalty for non-filing or incorrect filing of Form C and may also be subject to the general offence penalty under section 94(2).

As Singapore has also implemented country-by-country (CbC) reporting commencing 1 January 2017, penalties for non-filing, late filing or incorrect filing of CbC reports are now also applicable under the SITA under section 105M. Section 105M states that such penalties include a fine of up to SGD 10,000 or to imprisonment for a term not exceeding 2 years or both.

5. Conclusion

With mandatory TPD requirements now legislated and the introduction of significant TP penalties adjustments and surcharges, the IRAS is sending a clear signal that it is moving from a guidance-based approach to establishing a formal TP regime where it will seek to enforce TP compliance through the imposition of penalties. As such, it is important for taxpayers to ensure that proper and contemporaneous TPD is in place, as the first line of support for its cross-border related-party transactions.
More importantly, with the stakes for non-compliance raised considerably under the new TP penalty regime, companies should also ensure that they devote appropriate attention and processes to address relevant related-party transactions and their overall TP compliance with the new requirements. Even though certain taxpayers may not be required to prepare TPD under the exemptions stipulated under section 34F, the burden of proof of substantiating the arm’s length nature of their related-party transactions ultimately still rests with the taxpayers. As such, the reality is that all taxpayers are still expected to ensure that related-party transactions are carried out at arm’s length. For example, surcharges on TP adjustments are also imposed on taxpayers that are exempt from the preparation of TPD, and in some instances the only way to ensure that related-party transactions of such taxpayers are in line with the arm’s length principle would be for them to prepare and maintain the necessary TPD. In other cases, any year-end adjustments that taxpayers put through in their audited accounts also require substantiation in the form of a TPD. This would undoubtedly result in an increase in compliance costs given the legislation’s explicitly (or implicitly) requirement for Singapore taxpayers to prepare TPD to support the arm’s length nature of their related-party dealings.

Given Singapore’s tighter enforcement on TP offences, the incurrence of TP compliance costs and other associated costs relating to the preparation of TPD may be inevitable, if taxpayers want to avoid the tenfold increase in penalties or even surcharges on TP adjustments that may be applicable in the event of non-compliance of the arm’s length principle.

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