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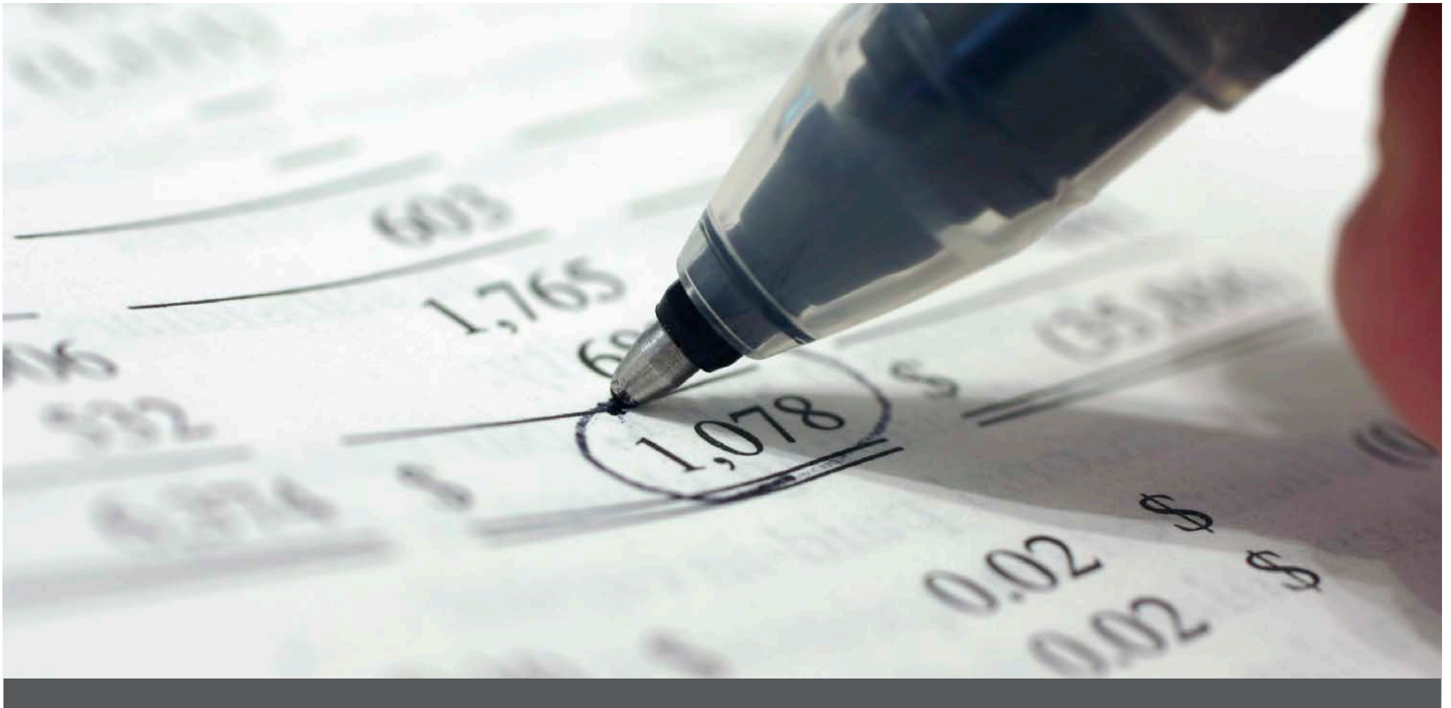
Bulletin Highlights

- Transfer Pricing
- Small Company exempt from audit requirement
- Increase in CPF rates for older workers aged above 50 years to 65 years



Transfer Pricing

(compiled by N Vimala Devi)

Why are tax authorities so interested to know the transfer prices that are adopted between related parties comply with the arm's length principle? The simple reason is that a multinational group can artificially shift income to achieve tax savings by taking advantage of the tax rates in the different jurisdictions. Often time and again the legal owners, financiers and the overall strategists and entrepreneurs that drive the global businesses are located in attractive low tax jurisdictions. The substantial share of the residual profits after leaving "an arm's length" margins in the supply value chain processes which are located in the various countries, are brought back to the legal owners, risk takers and entrepreneurs in low tax jurisdictions.

This traditional value chain transformation structures to maximize tax savings have come under scrutiny and attack by many tax authorities in the world. In UK, Starbucks, Amazon and Google have been challenged by the public and politicians for paying no tax or very little tax despite having substantial sales and operations in UK. What these multinational Enterprises ("MNEs") did was legitimate tax planning. However, nowadays, MNE are called on to pay their "fair" share of taxes.

Given the current sentiments of the tax authorities and with the introduction of Base Erosion and Profit Shifting ("BEPS") action plans by OECD to mitigate perceived loopholes in international tax rules, how MNEs commercially and economically organize their various businesses that can be substantiated in a consistent, transparent and substantive manner have become very critical. The focus is now moving from legal ownership structures to value creations. Just mere ownership framework without economic and financial substance will be likely challenged by tax authorities. The arm's length principle underpins the transfer price that should be adopted for transactions between related parties on the basis that such pricing should reflect the pricing adopted for transactions between unrelated parties.

BEPS project objective is to equip governments with the tools to ensure that profits are taxed where economic activities generating the profits are performed and where value is created as well as provide businesses greater certainty by reducing disputes over the application of international tax rules including standardizing compliance requirements. BEPS project's key elements are to implement county-by-county reporting ("CBCR") and launch a multilateral instrument to streamline implementation of tax treaty-related BEPS measures.

Singapore TP legislation

In 2010, Inland Revenue Authority of Singapore ("IRAS") has introduced TP legislation under Section 34D(1) of the Singapore Income Tax -

"Where 2 persons are related parties conditions are made or imposed between the 2 persons in their **commercial or financial relations** which **differ** from those which would be made if they were not related parties, then **any profits which would**, but for those conditions, **have accrued** to one of the persons, and, by reason of those conditions, **have not so accrued**, may be included in the profits of that person and taxed in accordance with the provisions of this Act."

The legislation is consistent with the arm's length principle that requires a transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party. If otherwise, IRAS will deem and assess to tax the profits that should have been accrued but was not accrued due to transfer pricing that is not justified based on commercial, financial and economic criteria.

With the imminent implementation of BEPS on 1 Jan 2017, IRAS has updated their TP guidelines that were first issued in 2006 and were last updated in 2009. The latest updated guidelines were issued on 6 January 2015.

Requirement to put in place contemporaneous TP documentation

Under the IRAS latest updated TP guidelines, taxpayers are required to prepare and keep **contemporaneous** TP documentation to support the pricing of their transactions with related parties as part of the record-keeping requirements for tax purposes. TP documentation must be adequate and prepared no later than the tax return filing date of the financial year end not later than by 30 November of the respective Year of Assessment. This is effective from year of assessment 2015.

TP documentation must be submitted to the IRAS **within 30 days upon request**; else taxpayer may be penalized under section 94(2) of the Act amongst other adverse consequences.

In a nut shell a contemporaneous TP documentation would include the following.

Group level: Provide an overview of the group's businesses that is relevant to the business operations in Singapore. Relevant information includes an overview of the group's global business, organization structure, the nature of the global business operations and overall transfer pricing policies.

Entity level: Provide details of the Singapore taxpayer's business and the transactions with its related parties, including functional and transfer pricing analysis.

Thereafter, do a comparability analysis based on functions performed, assets used as well as the risks assumed based on a value chain approach that takes into account the various financial, commercial and economic factors. Then identify the most appropriate transfer pricing method for the tested party. Determine the arm's length results and ensure that it is consistent when applied to the independent parties' comparable data.

IRAS Exemptions from TP documentation

However, IRAS has provided exemption for the requirement to put in contemporaneous TP documentation for the following transactions:

- Transaction with related party in Singapore (excluding related party loans) and both parties are subject to same Singapore tax rates
- Domestic loan between related parties in Singapore where the lender is not in the business of borrowing & lending
- The taxpayer applies the 5% cost mark-up for services that qualify as "routine" services defined in the guidelines
- Related party transactions covered by Advance pricing Agreement

Furthermore transactions that does not fall within the above exemptions, IRAS has given exemption for related party transactions that does not exceed the following thresholds:

Category of transaction (generally non-domestic)	Threshold in S$ per financial year
Purchase of goods from related parties	15 million
Sale of goods to related parties	15 million
Loans owed to related parties	15 million
Loans owed by related parties	15 million
All other related party transactions (e.g. services fees, royalties, rental, etc.)	1 million per category

Necessity for TP Documentation

Contemporaneous TP documentation is essential as it provides the taxpayer with the critical evidence that the pricing of the related party transaction is at arm's length. It ensures that related party transactions comply with the TP rules and regulations. By having this documentation it manages both domestic as well as cross border TP risks. It provides a defense against TP audit done by both local and overseas tax authorities. It also assists the taxpayer to invoke the Mutual Agreement Procedures under the tax treaties so that IRAS can act on the taxpayer's behalf to defend against a TP adjustment made by the other treaty country. In addition, it can also assist the taxpayer in negotiating for an Advance Pricing Arrangement with the tax authorities when required.

In summary, MNEs including any businesses with cross border related party transactions must be vigilant and ensure that their transfer pricing methodology is arrived at on arm's length basis and is defensible. Where such cross border transaction exceeds the exempt threshold, they must ensure that they put in place the contemporaneous TP documentation that supports the arm's length pricing.

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Small Company exempt from audit requirement

(compiled by Veronica Yat)

The "small company" concept (introduced by the Companies (Amendment) Act 2014) replaces the exempt private company for purposes of audit exemption which takes effect for financial periods starting on or after 1 July 2015.

Previous audit requirement

Prior to amendments to the Companies Act, a company was required to have an audit if:

a) it had at least one corporate shareholder;
b) it had more than 20 shareholders; or
c) its annual revenue was greater than S$5 million

New concept

A company qualifies as a "small company" for a given financial year if for the immediate past 2 financial years it meets the criteria.

Definition of Small Company

A company is defined as a "small company" for a given financial year if:

a) it is a private company; and
b) it satisfies at least two of the following three quantitative criteria in each of the immediate past two financial years:
    i) Total annual revenue of not more than S$10 million;
    ii) Total assets of not more than S$10 million;
    iii) Number of employees of not more than 50

The "small company" criteria recognise a broader group of stakeholders (for example, creditors, employees, customers, etc) who may have an interest in the financial statements, other than just shareholders.

There are mainly three scenarios to illustrate the application of the new "small company" concept, assuming these companies are not part of a group of companies:

1) Transitional provisions;
2) General applicability; and
3) New companies incorporated after the commencement of the "small company" criteria.

1) Transitional Provisions

The transitional provisions are applicable to companies that are incorporated before the date of the commencement of the new "small company" criteria. Such a company can qualify as a "small company" if it is a private company and meets the quantitative criteria in the first or second financial year commencing on or after the date of commencement of the "small company" criteria.

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Meets quantitative criteria	Yes	No	Yes	No	No	Yes
Qualifies as a "small company"	Yes	Yes	Yes	Yes	Yes	No
Remarks	FY 2015 is the first FY after the commencement of the "small company" criteria. The company qualifies as a "small company" as it is a private company and meets the quantitative criteria in FY 2015.	As the company already qualified as a "small company" in FY 2015, it continues to be a "small company" despite not meeting the quantitative criteria in FY 2016. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding FY 2016.	The company already qualified as a "small company" in FY 2015 and is not disqualified. It is not disqualified as it has only failed to meet the quantitative criteria for one of the two preceding FYs (that is, FY 2016).	As the company already qualified as a "small company" in FY 2015, it continues to be a "small company" despite not meeting the quantitative criteria in the current FY and for one of the two preceding FYs.		Although the company meets the quantitative criteria in the current FY, it is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2018 and FY 2019).

2) General Applicability

A company qualifies as a "small company" in a particular financial year if the company is a private company and meets the quantitative criteria in the previous two consecutive financial years.

i) Company meets the quantitative criteria in FY 2015 and FY 2016;
ii) Company is a "small company" in FY 2016.

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Meets quantitative criteria	No	No	Yes	Yes	Yes	Yes
Qualifies as a "small company"	Yes	Yes	No	No	Yes	Yes
Remarks	As the company already qualified as a "small company", it continues to be "small company" despite not meeting the quantitative criteria in the current FY. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY.		The company is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2017 and FY 2018).	As the company does not meet the quantitative criteria in the immediate past two consecutive FYs (that is, FY 2018 and FY 2019), it does not qualify as a "small company" in FY 2020.	The company qualifies as a "small company" as it meets the quantitative criteria in the immediate past two consecutive FYs (that is, FY 2019 and FY 2020).	The company continues to be a "small company" as it qualified as a "small company" in FY 2021 and is not disqualified.

3) Companies Incorporated after Commencement Date of "Small Company" Criteria

A company would qualify as a "small company" in its first or second financial year after incorporation if the company is a private company and meets the quantitative criteria in the financial year for which the financial statements are being prepared.

To summarise the above, the assessment for qualification as a "small company" would apply during the transitional period immediately after the commencement of the "small company" criteria and for the first two financial years of a new company. In addition, the disqualification as a "small company" only occurs when a company fails to meet the quantitative criteria for two consecutive preceding financial years.

Small group

A company that is a member of a group (either as a parent or a subsidiary company) will not qualify for exemption unless it is itself a small company and the group qualifies as a small group. A small group is one that meets the quantitative criteria for a small company on a consolidated basis. For this purpose, a "group" and the method of consolidation are determined by reference to the relevant accounting standards.

This principle applies regardless of whether the ultimate parent company is a Singapore or overseas company, and regardless of the financial reporting standards the ultimate parent company may use for the purposes of its consolidation.

To qualify as a "small group", the group must satisfy at least two of the following three quantitative criteria in each of the immediate past two financial years:

a) Consolidated revenue of not more than S$10 million;
b) Consolidated total assets of not more than S$10 million;
c) Total number of employees of the group of not more than 50.

Description	Ultimate Parent A	Intermediate Parent B	Subsidiary C	Group (Consolidated)	Criteria met?
Revenue	S$2,500,000	S$3,000,000	S$7,000,000 (including S$2,500,000 intercompany sales to Parent A)	S$10,000,000 (after elimination of intercompany sales to Parent A)	Yes
Total assets	S$6,000,000 (including S$500,000 investment in Intermediate Parent B)	S$4,000,000 (including S$1,000,000 investment in Subsidiary C)	S$1,000,000 (including S$500,000 intercompany balances owing from Parent A)	S$9,000,000 (after elimination of intercompany balances owing from Parent A and investments in subsidiaries)	Yes
Number of employees	9	15	26	50	Yes
				"small group" criteria met?	Yes

As a general rule, the application of the "small group" concept is assessed at the ultimate parent level, and the members of the group are determined in accordance with Singapore Financial Reporting Standards, regardless of whether that parent is incorporated in Singapore or overseas.

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DID YOU KNOW?

Increase in CPF rates for older workers aged above 50 years to 65 years

(compiled by Ng Li Ling)

With effect from 1 January 2016 the CPF ordinary wage ceiling will be increased from $5000 to $6000.

The CPF contribution rates for workers aged above 50 years to 65 years will be increased from 1 January 2016 as follows:

Employee Age (Years)	Increase in Contribution Rates		
	Employer %	Employee %	Total %
Above 50 to 55	+1	+1	+2
Above 55 to 60	+1	-	+1
Above 60 to 65	+0.5	-	+0.5

Taking into account the increase in contribution rates for older workers, the new CPF contribution and allocation rates for employees will be as follows with effect from 1 January 2016:

Employee Age (Years)	Increase in Contribution Rates		
	Employer %	Employee %	Total %
35 and below	17	20	37
Above 35 to 45	17	20	37
Above 45 to 50	17	20	37
Above 50 to 55	17	20	37
Above 55 to 60	13	13	26
Above 60 to 65	9	7.5	16.5
Above 65	7.5	5	12.5

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Writers' Caveat

These articles have merely attempted to provide a broad overview on the subject matters. They are not in any way intended to be comprehensive and no specific action should be taken on the basis of the above without consulting your professional advisors.