

## UPDATES ON THE TRANSFER PRICING RULES

8 July 2024

### INTRODUCTION

Section 34F of the Income Tax Act 1947 requires that every company, firm or trust has to mandatory prepare transfer pricing documentation ("TPD") as prescribed:

- a) if the gross revenue derived from its trade or business for the basis period concerned is more than S\$10 million; or
- b) if TPD was required to be prepared in the basis period immediately before the basis period concerned.

However, the Income Tax (Transfer Pricing Documentation) Rules 2018, provides that the above entities are exempted from preparation of TPD for **specified transactions** undertaken with their related parties when those transactions fall within the following categories:

- a) Related party domestic transaction (other than loan) subject to the same tax rate;
- b) *Related party domestic loan*;
- c) Related party loan (domestic or cross-border) on which the indicative margin is applied;
- d) Routine support services on which 5% cost mark-up is applied;
- e) Related party transaction covered by an Advance Pricing Agreement; and
- f) *Related party transaction not exceeding certain thresholds*.

On 10 June 2024, the above TPD exemption rules have been amended, namely the exemptions under b) *related party domestic loan* and f) *related party transaction not exceeding certain thresholds* categories. We outline below, the salient points of the amended TPD rules below.

### AMENDMENTS TO TRANSFER PRICING DOCUMENTATION EXEMPTION RULES FOR RELATED PARTY DOMESTIC LOAN

The condition before the amendment was related parties are exempted from preparing TPD if the related party who is lending the domestic loan is not in the business of borrowing and lending money. In addition, to keep compliance costs low, interest restriction was used as a proxy in place of arm's length methodology. Over time, especially with the introduction of IRAS indicative margin, the above proxy has become less relevant to achieve arm's length outcome.

With the new rules introduced, the conditions for the exemption of TPD for related party domestic loans have been divided into 2 categories. They are:

- (a) loan agreements that have been entered into prior to 1 January 2025; and
- (b) those entered into on or after 1 January 2025.

Taxpayers will be exempted from TPD if the following conditions are met:

- (a) Related party domestic loan agreements entered into **prior to 1 January 2025**

The party granting the loan of any amount is not in the business of borrowing and lending money.

(b) Related party domestic loan agreements entered into on or after 1 January 2025

- i) Neither party to the transaction is in the business of borrowing and lending money; and
- ii) The parties have agreed to apply the **indicative margin** for the year in which the loan is granted.

IRAS publishes the indicative margin at its website at [www.IRAS.gov.sg](http://www.IRAS.gov.sg) and this is updated at the beginning of each year.

## THE APPLICATION OF ARM-LENGTH PRINCIPLE TO RELATED PARTY LOANS

With the above changes, we also provide you with a summary of the application of the arm's-length principle with regard to related party domestic loans. This table, obtained from IRAS' updated Transfer Pricing Guidelines (7th Edition) dated 14 June 2024 is reproduced below:

Type of loans	Status of the parties to the loan	Application of arm's length principle
Related party domestic loans entered into <b>prior to 1 Jan 2025</b>	Where the lending party is <u>not</u> in the business of borrowing and lending	To restrict interest expense deduction as a proxy to arm's length principle.
	Where the lending party is in the business of borrowing and lending (e.g. banks or other financial institutions, finance and treasury centres)	To determine the interest rate based on arm's length principle.  Where the loan* does not exceed S\$15 million, IRAS indicative margin may be applied to the appropriate base reference rate applicable to the taxpayer to derive the interest rate.
Related party domestic loans entered into <b>on or after 1 Jan 2025</b>	Where neither of the parties are in the business of borrowing and lending	To apply the IRAS indicative margin to the appropriate base reference rate to derive the interest rate; <b>or</b>  To determine the interest rate based on arm's length principle if the indicative margin is not applied.
	Where either party is in the business of borrowing and lending	To determine the interest rate based on arm's length principle.  Where the loan* does not exceed S\$15 million, IRAS indicative margin may be applied to the appropriate base reference rate applicable to the taxpayer to derive the interest rate.
* Based on loan committed and not loan utilised.		

To recapitulate, IRAS does not regard interest-free related party loans as arm's length transactions, unless the taxpayer provides reliable evidence that independent parties under comparable circumstances would provide similar loans without charging of any interest.

## WHAT TAXPAYER HAS TO DO?

Going forward, interest expense restriction can no longer be used as a proxy for arm's length pricing. All related party domestic loans entered into on or after 1 January 2025 either has to apply IRAS indicative margin to the appropriate base reference rate to derive the interest rate or to determine the arm's length interest rate based on arm's length principles.

## WHICH APPROPRIATE BASE RATE TO APPLY TO THE INDICATIVE MARGIN?

IRAS has mentioned that for fixed rate related party loans, taxpayers can apply an appropriate swap rate as the base reference rate to the indicative margin. For S\$ denominated fixed rate related party loans, taxpayers can also consider applying an appropriate Singapore Government Securities ("SGS") yield rate as the base reference rate. SGS yield rates are available at [www.mas.gov.sg](http://www.mas.gov.sg).

For floating rate loans, taxpayers may use base reference rates such as Singapore Overnight Rate Average ("SORA"), Secured Overnight Financing Rate ("SOFR"), Sterling Overnight Index Average ("SONIA"), etc.

## INCREASE IN THE THRESHOLD FOR EXEMPTION OF TRANSFER PRICING DOCUMENTATION ON CERTAIN TRANSACTIONS BY RELATED PARTIES

In the latest update, IRAS has also increased the amount of threshold for the "threshold for related party transactions exemption" category. Effective from the Year of Assessment "YA" 2026 i.e. financial year ended 2025, the revised threshold are as follows:

Category transactions	Total value YA 2025 and before (S\$)	Total value YA 2026 and onwards (S\$)	Examples of transactions
Purchase of goods from a related party	15 million	15 million	Amount paid/payable by the taxpayer for the goods
Sale of goods to a related party	15 million	15 million	Gross revenue derived by the taxpayer from the sales
Loan granted to a related party	15 million	15 million	Principal amount of the loan
Loan granted by a related party	15 million	15 million	Principal amount of the loan

Provision of services by related party	1 million	2 million	Amount paid/payable for the service, i.e. service fee expenses
Provision of services to a related party	1 million	2 million	Gross revenue from service rendered, i.e. service fee income
Grant of a right to use movable property by a related party	1 million	2 million	Amount paid/payable for the grant, i.e. royalty expenses
Grant of a right to use movable property to a related party	1 million	2 million	Gross revenue from the grant of the right to use, i.e. royalty income
Lease of any property by a related party	1 million	2 million	Amount paid/payable for the lease, i.e. rental expenses
Lease of any property to a related party	1 million	2 million	Gross revenue from the lease, i.e. rental income
Grant of a guarantee by a related party	1 million	2 million	Amount paid/payable for the grant, i.e. guarantee expenses
Grant of a guarantee to a related party	1 million	2 million	Gross revenue from the grant, i.e. guarantee income
Any other transaction (based on each category)	1 million	2 million	Amount paid/payable under the transaction or gross revenue under the transaction, as the case may be

Table obtained from IRAS.

For the purposes of determining if the threshold is met, aggregation should be done for each category of related party transaction.

## WHAT DOES THIS MEAN TO THE TAXPAYER

With the increase in the threshold amount for exemption for certain transactions, a taxpayer's compliance burden is expected to be reduced.

However, please note that even if the TPD exemption threshold is met for a particular type of transaction, taxpayers are still required to provide contemporaneous documentation to justify that their transactions done with related parties are at arm's length basis although the documentation requirements are not as stringent as a full-blown TPD.

## OTHER UPDATES

There are also other updates including the dating of completion of the TPD, reviewing and refreshing TPD annually for long term loans, clarification on working capital comparability adjustment to account for differences in levels of working capital between a tested party and comparable independent parties, streamlining of the Mutual Agreement Procedure, etc.

We trust that your TP expert will advise you according when performing the TPD.

## FAILURE TO COMPLY WITH THE TRANSFER PRICING RULES

### PREPARATION OF TRANSFER PRICING DOCUMENTATION

A taxpayer shall be liable upon conviction, to a fine not exceeding S\$10,000 for an offence under the following circumstances:

- a) For failing to prepare TPD by the time of the statutory deadline for filing the tax return;
- b) For not preparing TPD with details and in the form and content as prescribed by the TPD Rules;
- c) For not retaining the TPD for a period of at least 5 years from the end of the basis period in which the transactions took place;
- d) For not submitting TPD within 30 days from the date of the written notice served by the Comptroller requiring the taxpayer to submit the TPD; or
- e) For providing any documentation that the taxpayer knows to be false or misleading.

### NON-COMPLIANCE WITH THE ARM'S LENGTH PRINCIPLE

Taxpayers will also be subject to a surcharge of 5% (regardless of whether there is a tax payable on the adjustment or not) once a TP adjustment is made by IRAS. The surcharge is payable within one month from the date of a written notice issued by the Comptroller. The surcharge is not tax deductible.

Taxpayers may voluntarily make upward adjustments for past financial years on their related party transactions. Such self-initiated retrospective upward adjustments are similarly subject to a 5% surcharge regardless of whether there is a tax payable due to the adjustments.

## DEFINITIONS

For your ease of reference, we have also listed some of the relevant definitions below:

**Arm's length principle:** The arm's length principle is the international standard to guide transfer pricing. It requires the transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party.

**Arm's length interest rate:** The arm's length interest rate is the interest rate which would have been charged between independent parties under similar circumstances at the time the indebtedness arose.

**Related party:** Two persons are related parties with respect to each other if: (a) Either person, directly or indirectly, controls the other person; or (b) Both persons are, directly or indirectly, controlled by a common person.

**Related party domestic loan:** Where a taxpayer in Singapore lends to or borrows from a related party in Singapore

**Related party cross- border loan:** Where a taxpayer in Singapore lends to or borrows from a foreign related party

## HOW WE CAN HELP?

Should you require further clarification on the above, please contact us.

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