Tax Alert

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Basis of Assessment for Service Companies (Updates)

In our Tax Alert Issue 25, we provided details of the clarifications made by the Inland Revenue Authority of Singapore (IRAS) on the application of Cost Plus Mark Up basis of assessment for service companies (CM Basis) and how certain companies will be affected.

The IRAS has recently provided further clarifications on the scope of CM Basis and the rules for companies transiting from CM Basis to the Normal Trading Company basis of assessment (NTC Basis).

In this issue, we provide an update on the scope of CM Basis and details of the transitional rules as clarified by IRAS.

A quick recap

To recap, IRAS' position is that the CM Basis is strictly for service companies providing routine support services as listed in Annex C of IRAS e-Tax Guide on Transfer Pricing (TP) Guidelines to only related parties.

Where the CM Basis is adopted, the chargeable income is computed based on 5% mark-up on total expenditure, without any further adjustments.

Consequently, the following companies (Relevant Companies) would have to transit to NTC Basis with effect from Year of Assessment (YA) 2019:

1) Companies that fall outside the scope of CM Basis and have adopted the CM Basis; and
2) Service companies on CM Basis which are seeking to make tax adjustments and tax claims.

IRAS update on the scope of CM Basis

In February 2018, IRAS provided the following clarifications:

- Relevant Companies have to transit from CM Basis to NTC Basis latest by **YA 2020** (instead of YA 2019 being the transitional year);
- CM Basis is only applicable to service companies that adopt a 5% mark-up on expenditure as the arm's length charge for the routine support services;
- For CM Basis, total expenditure used to compute service income based on a 5% mark-up should exclude gains on disposal of fixed assets and foreign exchange gain on revenue account but not revenue grant. The revenue grant, together with the computed service income (based on 5% mark-up on total expenditure of providing the routine support services), forms the chargeable income of the service company.

IRAS update on the transitional rules

The IRAS has indicated that the following rules would be applicable to companies transiting from CM Basis to NTC Basis in the YA of transition.

Tax item	Tax Treatment in transition YA and after
Section 14Q deduction (for renovation or refurbishment expenditure incurred in basis periods relating to YAs prior to the transition YA)	
• For expenditure that has been capitalised in the accounts	• Section 14Q deduction will be computed based on opening net book value (NBV) at the start of transition YA. The relevant 3-year period will commence from transition YA.
• For expenditure that has been expensed off previously	• No Section 14Q deduction
Capital allowances (CA) on qualifying plant and machinery acquired in basis periods relating to YAs prior to transition YA	CA will be computed based on opening NBV of the asset at the start of the basis period relating to the transition YA.
Provision made prior to transition YA	
• General provisions (e.g. provision for warranty, staff leave)	• Provisions utilised will be allowable and provisions written back will not be taxable.
• Specific provisions (e.g. specific provision for doubtful debts, provision for contractual bonus, provision for non-contractual bonus where payments are made in the following year)	• Provisions utilised will not be allowable and provisions written back will be taxable as the provisions would be considered to have been claimed in the year the provisions were made.

Our comments

With the details of the transitional rules, Relevant Companies should assess the transitional impact and make a decision on whether they would like to transit into NTC Basis in YA 2019 or 2020, taking into account the following:

a) their renovation and plant/machinery expenditures incurred during their financial year ended in 2018 vis-à-vis their plan for such expenditures for financial year ending in 2019; and

b) how the transition into FRS 109 tax treatment will also impact their claims for specific provision for doubtful debts.

Whilst the transitional rules cover most items which straddle across the transition YA, it is silent on the applicable tax treatment in relation to disposal of plant and machinery.

Service companies providing routine support services as listed in Annex C of TP Guidelines and adopting the CM Basis should continue to monitor their scope of services to ensure that they continue to qualify for the CM Basis. Once the scope of services fall outside those list in Annex C, they will have to transit to the NTC Basis.

How we can help

The routine support services as listed in Annex C of TP Guidelines are not meant to be exhaustive. Should you render other routine support services to related parties that do not fall within the list in the Annex C of TP Guidelines; or if you have doubts whether your company can continue to adopt the CM Basis; or if you have a tax item for which the transitional tax treatment has not been clarified by the IRAS, we will be happy to discuss your issue(s).

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