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Singapore Latest (4th) Edition of Transfer Pricing Guidelines – Released on 12 January 2017

On 12 January 2017 the Inland Revenue Authority of Singapore ("the IRAS") released the fourth edition of the Singapore Transfer Pricing Guidelines (4th edition of TP guidelines). The changes reflect Singapore's commitment to implement the four minimum standards under the Base Erosion Profit Shifting (BEPS) project published by the OECD as well as IRAS' commitment to adhere to the Transfer Pricing Principles developed pursuant to the BEPS Actions 8 – 10.

The key messages are:

- The IRAS has clearly stated its position and alignment with the international practice that "profits should be taxed where the real economic activities generating the profits are performed and where value is created". In this respect, the IRAS has adopted the latest OECD's guidance to be followed in the conduct of the functional analysis to be undertaken as part of the transfer pricing analysis, in particular concerning risk-management and -assumption (sections 5.20 – 5.23).

- The IRAS has introduced a safe-harbour administrative practice for intercompany loans not exceeding 15 mSGD, relieving related companies to proceed with a detailed transfer pricing analysis for the determination of the arm's length interest to be charged. This safe harbour is implemented through the mechanism of an indicative margin published on the IRAS website annually. The indicative margin should apply on an appropriate base reference rate.

Please find hereafter a summary of the relevant key points and what their implications for taxpayers are.

1. Transfer Pricing Documentation

a. Enhancements to the Functional Analysis

The IRAS has again emphasised that the application of the arm's length principle will lead to an appropriate profit allocation in line with substance, value creation and commercial realities. The newly included paragraphs (sections 5.20-5.22) state in accordance with the BEPS Actions 8-10 that the level of return derived by a taxpayer in a related-party transaction should be directly

correlated to its function and risk profile. The functional profile of an entity is determined by the functions performed, risks assumed and assets employed in performing said functions.

In particular, the IRAS has stressed that the assumption of risk means that the taxpayer has to be able to control and manage such risk and have the financial capacity to assume said risk. Certain examples (e.g. assumption of credit risk or inventory risk) have been used to illustrate the direct link between risk assumption and level of return. In this respect, a taxpayer, who has the functional and financial capacity to manage a given risk and who effectively manages such risk, should be entitled to a greater return compared to another taxpayer who does not have the capacities to perform both activities.

For transfer pricing documentation purposes, a robust functional analysis is therefore more than ever crucial, particularly further information on risk recognition and commercial and economic considerations have to be included in order to allow a meaningful comparison of prices and margins between taxpayers and transactions.

The focus on aspects of risk recognition is admittedly challenging to apply in practice and it changes the transfer pricing environment in Singapore. Therefore, taxpayers should reassess the functional profile of the entities involved in intercompany transactions subject to transfer pricing documentation. Where the level of risks borne or managed does not meet the abovementioned conditions a recalibration of the functional profiles of the entities involved may be considered.

b. Additional Information Requirements

In accordance with BEPS Action 5 as well as BEPS Action 13 taxpayers have now the obligation to include the following information in the transfer pricing documentation:

- Copies of existing Advance Pricing Agreements – “APA” - (unilateral or bi-/multilateral) and other tax rulings to which the IRAS is not a party and which relate to the allocation of income among countries.
- Documents relating to the justification of the pricing and comparability adjustments performed by the taxpayer.

In practice, we assume that taxpayers may expect more detailed information requests from IRAS within transfer pricing audits.

2. Indicative Margin for Intercompany Loans

To facilitate the compliance with the arm’s length principle and to relieve taxpayers from performing a detailed transfer pricing analysis for the determination of the arm’s length interest on their intercompany loans, the IRAS will allow taxpayers to use an indicative margin. This indicative margin will be published every year on the IRAS’s website and is to be applied on a base refe-

rence rate considering the attributes of the intercompany loan (SIBOR for fixed rate loans and LIBOR for floating rate loans).

The option to make application of this indicative margin is restricted to each of a taxpayer's related loan which do not exceed 15 mSGD at the time the loan is provided or received.

If the application of the indicative margin is chosen, the taxpayer will not be required to prove the arm's length pricing of the loan with other documentary evidence. Further, such qualifying loans (not exceeding 15 mSGD) will not be counted toward the 15 mSGD-threshold requiring a relevant taxpayer to prepare a thorough transfer pricing documentation.

Therefore, the indicative margin simplifies the compliance burden and lowers transfer pricing risks for taxpayer significantly.

However, the acceptance of the indicative margin by foreign tax authorities remain to be seen. In addition, taxpayers will now potentially find themselves in a defending position if they do not apply the indicative margin on eligible intercompany loans. This is because IRAS officers may in practice be guided by the indicative margin in their assessment of the application of the arm's length principle.

The indicative margin is only applicable for intercompany loans not exceeding 15 mSGD. Taxpayers are still required to prepare a contemporaneous transfer pricing documentation for intercompany loans exceeding the 15 mSGD-threshold.

The indicative margin is determined every year and will be published at the beginning of the year on the IRAS website. For the fiscal year 2017, the indicative margin has been set at +250 bps (2.5 %).

3. Miscellaneous

- No contemporaneous transfer pricing documentation is required for guarantee income and guarantee expenses each not exceeding 1 mSGD.

- Strict pass-through costs should be included in aggregating the value of each category of intercompany transactions to determine whether these transactions surpass the relevant threshold limit. Taxpayers should review the intercompany transactions subject to transfer pricing documentation taken into account the passed through costs.

- With respect to Mutual Agreement Procedures ("MAP") and APA procedures, the IRAS has mentioned that:

- if taxpayers choose to accept the outcome of a transfer pricing audit with a foreign tax authority, any unprejudiced negotiation between the IRAS and the foreign tax authorities to eliminate the double taxation may be challenging.

- if a transfer pricing issue is resolved through a legal or judicial proceeding, IRAS is unlikely to amend the transfer pricing adjustments that will be at odds with the determination by Singapore tribunals and courts.

Although both views do not represent a new position of the IRAS taxpayers will have to monitor the different options to resolve the double taxation under domestic law carefully taking into account all historical and future tax consequences.

For further guidance, information and assistance please feel free to contact us anytime.

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