Singapore issues revised Transfer Pricing Guidelines with new guidance on CCAs

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In brief

The Inland Revenue Authority of Singapore (IRAS) issued revised Transfer Pricing Guidelines (Sixth Edition) (6th Edn TPG) on August 10. While there are no fundamental changes from the 5th Edn TPG, the 6th Edn TPG provides new guidance on cost contribution arrangements (CCAs) and enhanced guidance on financial transactions, intercompany services and transfer pricing (TP) audits and adjustments.

The 6th Edn TPG reflects a change in tone, with more focus on the quality of transfer pricing documentation (TPD), audit, and enforcement. Following two IRAS e-Tax Guides on special topics — addressing the TP aspects of centralized activities in multinational enterprise groups and commodity marketing and trading activities — the release of the 6th Edn TPG suggests taxpayers can expect closer and more forensic examinations of their TP arrangements going forward.

Observation: The 6th Edn TPG is more closely aligned with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (July 2017) (OECD TPG), and reference has been made to the mandatory binding arbitration procedures that are available under many of Singapore's post BEPS double-taxation treaties, with a potential application to future bilateral tax disputes.

Action item: Taxpayers should take the opportunity to analyze whether their TP arrangements and TPD meet required standards in seeking to reduce the risk of costly disputes and potential TP adjustments.

In detail

Quality of transfer pricing documentation

The 6th Edn TPG includes a new section on Frequently Asked Questions in relation to TPD (Section 6 Appendix B). This section deals with matters that must be covered in the TPD and additional matters that IRAS notes "will be useful" to cover.

Note: It is reasonable to expect IRAS to focus on items that "will be useful" in a TP audit, where not addressed in the TPD — e.g., explanation of the contribution of related parties to the overall value chain, the reasons for entering into a particular transaction, and an explanation of margin performance vis-à-vis competitors and selected comparables. Elsewhere, in the section on TP adjustments, IRAS specifically addresses the circumstances in which it would disregard a transaction, drawing on the language of the OECD TPG to highlight that in the exceptional circumstance that a transaction is commercially irrational and cannot, for that reason, be benchmarked, it may be disregarded or re-constructed.

Observation: Also taking into account the attention drawn to the importance of the risk control framework in the IRAS e-Tax Guide on Centralised Activities in Multinational Enterprise Groups (issued on March 19, 2021), taxpayers should expect, upon audit, a deeper and more forensic examination of their substance and of the overall commercial rationale for entering into the transactions that are presented. Taxpayers should not assume TP audits will be limited merely to an examination of the pricing of the transaction presented. Instead, taxpayers should be prepared to explain why entering into tested transactions was arm's length in the first place, having regard to the surrounding economic circumstances and the options realistically available to the parties.

Intercompany services

Section 14 has been re-drafted in the 6th Edn TPG to more closely align with the OECD TPG. A fuller explanation of the benefits test and the treatment of stewardship costs are provided, with specific reference to the OECD TPG. In addition, the list of activities qualifying for the 5% routine services markup safe harbor (Annex C) has been expanded. In a further administrative concession, services that are not listed in Annex C but which do meet the OECD TPG definition for low-value-adding services similarly may be charged with a 5% markup, provided the treatment is accepted on both sides of the transaction and subject to the satisfaction of other factors such as internal comparability. ***Note:*** This does not remove the requirement to prepare contemporaneous TPD.

TP audit, TP adjustments, and Bilateral Advance Pricing Agreements (BAPAs)

The guidelines on TP compliance in the 5th Edn TPG have been amended in the 6th Edn TPG to reflect the shift in focus; TP consultations are re-named TP audits.

New sections 8 and 9 have been introduced to the 6th Edn TPG, to provide more comprehensive guidance on TP adjustments (either taxpayer-initiated or IRAS-initiated) and on the application of the 5% surcharge, which is applied to the gross value of upward adjustments. IRAS reminds taxpayers that the 5% surcharge automatically applies to an upward TP adjustment (except where agreed between Competent Authorities) unless remission is offered, at the sole discretion of the comptroller. Factors to be taken into account in the exercise of this discretion include the taxpayer’s compliance history, the preparation of contemporaneous TPD, and cooperation through the audit process.

To encourage voluntary disclosure of TP positions that may require adjustments, IRAS notes that full remission of the 5% surcharge will be available to taxpayers making upward self-initiated TP adjustments within two years of the tax return filing deadline, provided the adjustment is prior to any queries being raised by IRAS or the receipt of a TP audit notification, and provided further that the above-mentioned factors are satisfied.

Note: Self-initiated retrospective downward adjustments will not be accepted by IRAS unless the adjustments are due to an error or mistake under Section 93(1A) of the Income Tax Act and are supported by contemporaneous TP documentation.

The guidance on the process for initiating BAPAs has been updated, most notably to draw taxpayers’ attention to the fact that IRAS will not entertain BAPAs for transactions undertaken mainly for tax avoidance purposes. ***Observation:*** This does not represent a change in practice for IRAS, but does serve to underline the fact that BAPA applications are accepted at IRAS’s discretion.

Cost contribution arrangements

The 6th Edn TPG provides detailed guidance on CCAs through the introduction of Chapter 17, which is aligned with the OECD TPG.

Observation: The emphasis IRAS places on the value of current contributions to a CCA — specifically noting that the cost of current contributions does not necessarily reflect the value of such contributions — is key. Instead, each CCA participant's contribution should be valued at arm's length. This may mean that cost contributions should be rewarded with a markup, although in some circumstances, IRAS may be prepared to accept measuring contributions at cost. Taxpayers with CCAs, particularly those with substantial contributions by the Singapore taxpayer, should consider revisiting the methodology employed in light of the new guidance.

It is also noteworthy that IRAS has provided guidance on the Singapore corporate income tax treatment for payments under CCAs. This reminds taxpayers to consider the interaction between transfer pricing and the taxability/deductibility aspects of CCA payments.

Related-party financial transactions

IRAS has provided further guidance on the application of the arm's-length principle to related-party financial transactions other than related-party loans, such as cash pooling arrangements, hedging transactions, financial guarantees, and captive insurance. When applying the arm's-length principle, IRAS expects taxpayers to take guidance from the OECD Transfer Pricing Guidance on Financial Transactions issued on February 11, 2020 (OECD FT TP Guidance).

In relation to related-party loans, IRAS also has provided the following key updates, which mostly are in line with the OECD FT TP Guidance:

- A summary of economically relevant characteristics that may be useful indicators in assessing whether a purported loan should be regarded as a loan.
- A reminder that the creditworthiness of the borrower is one of the main factors in determining an arm's-length interest rate, together with guidance on the circumstances in which the implicit support that arises from group membership should be considered in establishing the borrower's creditworthiness.
- A confirmation that taxpayers can choose to determine the arm's-length interest rate for comparable loans on an aggregate basis, using similar loan features as a way to aggregate the loans. This should help to reduce compliance costs.
- A confirmation that IRAS will not regard interest-free related party loans as arm's-length transactions unless taxpayers have reliable evidence that independent parties under comparable circumstances would similarly provide such loans without charging any interest.

Note: The 6th Edn TPG does not touch on the TP considerations relating to the anticipated cessation of (most) LIBOR rates after December 31, 2021. We expect that IRAS will provide an update on this.

Let's talk

For a deeper discussion of how Singapore's revised Transfer Pricing Guidelines might affect your business, please contact:

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