Singapore's updated Transfer Pricing Guidelines incorporate BEPS Actions developments

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In brief

The Inland Revenue Authority of Singapore (IRAS) released its Fourth Edition Transfer Pricing Guidelines (4th Edn TPG) on January 12, 2017. The new edition reflects the IRAS' approach to regularly update, generally on an annual basis, its transfer pricing guidance to align with international tax developments and accepted practices, including those emanating from the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) initiative.

In detail

In its 4th Edn TPG, the IRAS — besides clarifying or elaborating on certain aspects of the guidance given in the previous edition — sets forth Singapore's position on transfer pricing in alignment with various announcements made by the Ministry of Finance (MoF) when Singapore committed to joining the OECD's "Inclusive Framework for Implementing Measures against Base Erosion and Profit Shifting ("BEPS")" on June 16, 2016, as well as other BEPS developments.

The key messages from the updates in the 4th Edn TPG are as follows:

- The IRAS has reinforced its position that "profits should be taxed where the real economic activities generating the profits are performed and where value is created" by explicitly expounding its adherence to this principle in its latest guidance[1].
- The IRAS has re-emphasized the importance of robust functional analysis as part of transfer pricing documentation. Additional guidance is provided on how risk assumption is to be considered under the arm's-length principle. In summary, to assume a risk for transfer pricing purposes a taxpayer needs to control the risk and have the financial capacity to assume the risk. Examples of the documentary evidence that a taxpayer should maintain to support its functional, asset, and risk characterisation also are provided[2].
- The IRAS has stressed the need to include commercial and economic considerations in functional analysis for a meaningful comparison of prices or margins between taxpayers or transactions[3].
- The IRAS has aligned its TPG with the IRAS' e-Tax Guide on Country-by-Country Reporting issued on October 10, 2016[4] by incorporating the obligation of the ultimate parent entity of a Singapore multinational enterprise (MNE) group to file a Country-by-Country (CbC) Report if the reporting threshold is met. This is in

addition to complying with contemporaneous transfer pricing documentation requirements.

- The IRAS now requires that the documentation include a copy of existing unilateral and bilateral/ multilateral advance pricing arrangements and other tax rulings to which IRAS is not a party and which pertain to related-party transactions subject to transfer pricing documentation in Singapore[5]. This is consistent with the IRAS' aligned position with the Final Report on BEPS Action 5 "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance" published by the OECD in October 2015[6] (BEPS Action 5 Final Report), whereby the IRAS has set out the framework under which it will engage in compulsory spontaneous exchange of information on cross-border unilateral APAs in specified situations.
- The IRAS for the first time has introduced a safe-harbour administrative practice for related-party loans not exceeding the equivalent of S$15 million in the form of an indicative margin over an appropriate base reference rate, to facilitate compliance with the arm's-length principle in respect of such transactions[7].
- Among various updates to its guidance on Mutual Agreement Procedures (MAP) and Advance Pricing Agreements (APAs), the IRAS has explicitly stated that a taxpayer's decision to accept transfer pricing audit settlement with a foreign competent authority will make it challenging for the IRAS to have an unprejudiced negotiation with the foreign competent authority to eliminate double taxation that arises from the audit[8].
- The IRAS has, by way of a footnote (Footnote 11), required that strict pass-through costs be included in the computation of the amount of related-party transactions for the purpose of determining if the threshold is met for which taxpayers are expected to prepare and maintain contemporaneous transfer pricing documentation for the transactions.

We discuss below the implications of these latest developments.

Implications

Aligning appropriate profit allocation with substance, value creation, and commercial reality

The MoF and the IRAS have articulated on multiple occasions Singapore's adherence to this principle. With the issuance of the final deliverables under Action Plans 8-10 around Transfer Pricing principles, the IRAS has now updated the 4th Edn TPG to reiterate this principle.

More importantly, additional guidance is included on how the IRAS will view the concept of risk assumption as part of the functional, asset, and risk characterisation in an intercompany transaction. Put simply, the IRAS expects that where risks are purported to be assumed in an intercompany transaction, taxpayers will need to be able to demonstrate:

- Differentiation between risks mitigation and risks assumption, where the IRAS views that different levels of remuneration are to be due in these circumstances; and
- Ability to control the risks and financial capacity to assume the risks.

The IRAS has used certain examples (e.g., assumption of credit or inventory risks) to illustrate the documentary evidence of risks assumed that it expects to see as part of a taxpayer's contemporaneous transfer pricing documentation.

The IRAS also has explicitly spelt out that commercial and economic circumstances should be included as part of the functional, asset, and risk analysis.

With these updates, taxpayers should ensure their transfer pricing documentation articulates these considerations and that they have the supporting documentation needed to practically demonstrate their fact pattern to the IRAS.

Observations

The focus on risk recognition is a key concept that can be challenging to apply in practice. Many MNE groups may choose, for various commercial and risk management reasons, to conduct different aspects of their functional activities, asset ownership, and risk assumption activities within different affiliates. Although the principles may be clear, applying them to the specific facts and circumstances of these MNE groups may result in complex analyses and/or be subject to different interpretation by different parties. Accordingly, MNE groups should (re)assess in greater depth the issues around segregation of functions, assets, and risks in different territories, and clearly articulate their view on the relative importance of these aspects with respect to the specific fact pattern.

MNE groups also should consider whether to document the relevant facts and circumstances on an ex post or an ex ante basis, as part of contemporaneous transfer pricing documentation or other supporting documentary evidence. Either way, we recommend that MNE groups bring forward their process for maintaining robust transfer pricing documentation on a more 'real-time' basis. This approach should help reduce the challenge of searching for supporting evidence long after the transaction has been executed.

Many taxpayers that have received tax queries from the IRAS on transfer pricing related matters, or that have participated in IRAS' transfer pricing Consultations, MAP, or APA discussions, should not find all these to be new developments. The IRAS' line of query progressively has become more intense and now commonly requires the provision of extensive supporting materials to demonstrate adherence to the arm's-length principle for group transactions.

Although some taxpayers may consider these developments to impose excessive obligations and compliance burdens, others will note that these developments are not unique to Singapore or more onerous than those elsewhere. The IRAS views these developments as appropriate to secure Singapore's tax base and ensure Singapore is not used as an intermediary for facilitating BEPS activities, through the robust application of the arm's-length principle.

Updated MAP and APA guidelines

In the 3rd Edn TPG issued on January 4, 2016, the IRAS provided updated guidance on the procedures and considerations for taxpayers interested in initiating MAP and APA discussions with the IRAS. Please see PwC's summary for these changes.

In the latest 4th Edn TPG, aside from a number of administrative updates and clarifications, the IRAS articulated that "taxpayers must also recognise that if they choose to accept a transfer pricing audit settlement with a foreign competent authority, any unprejudiced negotiation between the IRAS and the foreign competent authority to eliminate double taxation arising from the audit could be challenging"[9].

While this does not represent a new position of the IRAS, the explicit articulation of the position in the 4th Edn TPG serves to warn taxpayers against making unilateral settlement efforts of any form, on the ground that such efforts would be viewed as jeopardizing the IRAS' negotiation efforts with other competent authorities to eliminate double taxation resulting from transfer pricing adjustments. Under this view, taxpayers entering into unilateral settlements may, regardless of the reasons for doing so, risk the non-admission of the MAP request or the discontinuation of the negotiation by the IRAS due to the challenge posed.

Observations

Taxpayers should consider their dispute resolution strategy and start engaging IRAS early in the dispute resolution process. Although bilateral government-to-government discussions may, at first sight, seem more time-consuming and require more resources, having such bilateral discussions can help secure a more balanced and considered outcome.

In addition, once the MAP process is in place, taxpayers should allow the competent authorities to resolve the dispute through due process. Whilst taxpayers should facilitate the competent authorities in their negotiation with robust and prompt information support, it is advisable to refrain from making efforts to settle the dispute with one or more competent authorities concurrently.

The IRAS also articulated that "where the matter (i.e., dispute) has been subjected to litigation and determination by the Singapore tribunals and courts, IRAS is unlikely to amend the transfer pricing adjustments that will be at odds with the determination by the Singapore tribunals and courts."[10]

Observations

This is not a new position of the IRAS. However, the articulation of this position in the 4th Edn TPG serves to make clear the IRAS' viewpoint in such a situation. This also serves to address the issue of taxpayers possibly invoking the MAP process with the view of overturning or rectifying an outcome determined through the due domestic legal process.

Disclosure of unilateral APAs in transfer pricing documentation and spontaneous exchange of information on cross-border unilateral APAs

These are probably the most significant updates in the 4th Edn TPG.

On contents that should be included in transfer pricing documentation, the IRAS for the first time has set out a requirement that taxpayers include in their contemporaneous transfer pricing documentation a copy of the existing unilateral and bilateral/multilateral APAs and other tax rulings to which the IRAS is not a party and that are related to related-party transactions subject to the transfer pricing documentation.

On exchange of information on cross-border unilateral APAs, the IRAS has also for the first time has spelt out the framework under which the IRAS will do so. This is in line with the commitment for mandatory spontaneous exchange of information of APAs and tax rulings in the BEPS Action 5 Final Report. Specifically, the IRAS will spontaneously exchange information on cross-border unilateral APAs with:

- Jurisdictions of residence of all related parties with which the taxpayer enters into transactions that are covered by the unilateral APAs; and
- Jurisdictions of residence of the taxpayer's ultimate parent entity and the immediate parent entity provided that these jurisdictions:
  - Have a tax treaty or exchange of information instrument with Singapore;
  - Have the necessary legal framework and safeguards to ensure confidentiality and appropriate use of the information exchanged; and
  - Are similarly committed to compulsory spontaneous exchange of information on cross-border unilateral APAs under the framework agreed in the BEPS Action 5 Final Report.

The IRAS' schedule, reproduced below, states that it will engage in exchange of information on cross-border unilateral APAs issued prior to January 12, 2017, the date of release of the 4th Edn TPG, in the following manner:

Unilateral APAs	Timing of information exchange
• Issued on or after January 1, 2012 and still in effect on January 1, 2015 • Issued on or after January 1, 2015 but before April 1, 2017	By December 2017
• Issued on or after April 1, 2017	Within three months after date of agreement

The exchange of past rulings appears consistent with the recommendation of the OECD BEPS Action 5 report on countering harmful tax practices, which noted that the timelines for such exchanges will be subject to local laws (taking into account the effective date of the relevant Exchange of Information instruments).

Observations

Unlike with unilateral APAs, there is no mention in the 4th Edn TPG that APAs concluded on a bilateral or multilateral basis need to be shared with jurisdictions beyond the covered jurisdictions (e.g., jurisdictions of residence of the taxpayer's ultimate parent entity and the immediate parent entity). This seems appropriate as such potential exchange of information should be governed by the provisions of the relevant tax treaties.

In comparison, however, the scope of exchange of information for unilateral APAs is broader than that for bilateral/multilateral APAs. This may lead to unforeseen consequences that may need to be addressed by a MNE group. MNE groups therefore should consider the implications of the latest developments in determining their future dispute prevention strategy.

In conjunction with CbC reporting developments that will provide high-level information on profit allocation across a MNE group's global operations, the disclosure and spontaneous exchange of information of tax rulings and unilateral APAs will provide a further level of detail of the group's overall tax and transfer pricing model.

In light of these developments, taxpayers should take any steps needed to deploy and implement a coherent and consistent tax and transfer pricing model in line with business and commercial reality, and in accordance with the arm's-length principle. Tax authorities will have access to more information to assess the adequacy of transfer pricing models and tax structures. Taxpayers should take this into account when planning and supporting their tax models in line with operational substance and commercial realities.

Introduction of indicative margins for intercompany loans

To facilitate compliance with the arm's-length principle, the IRAS has introduced an indicative margin which taxpayers may apply on their related-party loans obtained or provided from January 1, 2017 onwards, provided that the loan amount does not exceed the equivalent of S$15 million at the time the loan is obtained or provided ('eligible related party loans'). The threshold is determined based on the loan committed and not the loan utilised.

The indicative margin will be published on the IRAS website and will be updated at the beginning of each year. The indicative margin published on the IRAS website applicable for the period January 1, 2017 to December 31, 2017 is +250 bp (2.5%).

The indicative margin, to be applied to an appropriate base reference rate, is not mandatory; rather, it serves to provide taxpayers with an alternative to performing detailed transfer pricing analysis on their eligible related-party loans. The indicative margin approach may apply to both Singapore-dollar denominated and foreign-currency denominated eligible related-party loans. For foreign-currency denominated related party loans, the Singapore dollar equivalent of the loan amount is to be determined based on the prevailing exchange rate at the time the loan is obtained or provided.

Taxpayers may adopt a margin that is different from the indicative margin, but should support the margin adopted with robust transfer pricing analysis and documentation.

Taxpayers may decide on the appropriate base reference rate on which to apply the indicative margin based on the attributes of the loans (e.g., Singapore Government Securities yield for fixed-rate loans, SIBOR or LIBOR for floating-rate loans).

Taxpayers with related-party loans exceeding the equivalent of S$15 million at the time the loan is obtained or provided must continue to support the arm's-length pricing of the loans with robust transfer pricing analysis and documentation.

Observations

The loan threshold for applying the indicative margin approach is aligned with the safe harbour threshold under which the preparation of contemporaneous transfer pricing documentation for related-party loans is not expected. Although contemporaneous transfer pricing documentation is not expected for related-party loans not more than the equivalent of S$15 million, a taxpayer still must prove the arm's-length pricing of the loan with other documentary evidence if called upon to do so by the IRAS. Accordingly, this indicative margin approach is a welcome development for taxpayers that wish to charge an interest rate that is acceptable to the IRAS from a transfer pricing perspective without having to undertake an elaborate transfer pricing analysis.

Taxpayers that do not apply the indicative margin to the appropriate base reference rate now potentially may find themselves having to defend the arm's-length nature of the interest charged. This is because IRAS officers in practice may be guided by the indicative margin in their enforcement of the arm's-length principle and question the basis of the interest rates for such related-party loans.

In addition, taxpayers should note that although the interest rate as determined by applying the indicative margin to the appropriate base reference rate for eligible related-party loans will be acceptable to the IRAS, it may not be accepted by the tax authority of a foreign jurisdiction in which the counter-party borrowing or lending entity is based. Hence, taxpayers should consider their own credit quality, as well as other features of the loans (e.g., duration and call features), in assessing whether they should adopt the safe harbour margin.

The indicative margin approach is only applicable for eligible related-party loans obtained or provided from January 1, 2017 onwards. The approach does not apply to eligible related-party loans obtained or provided prior to January 1, 2017. (In any case, there is no indicative margin published by the IRAS for periods prior to January 1, 2017.) As a result, taxpayers with eligible related-party loans will continue to have to prove the arm's-length pricing of these loans if asked to do so by the IRAS, although they are not expected to prepare contemporaneous transfer pricing documentation for these loans.

While a safe harbour margin has been prescribed for eligible related-party loans, no such safe harbour rate is available for guarantees. Conceptually, return on guarantee represents the credit risk premium in a borrowing arrangement. As such, it would be useful for the IRAS to align the two arrangements in formulating the safe harbour for financing arrangements.

Determination of threshold of related-party transactions for which contemporaneous transfer pricing documentation should be maintained

The IRAS expects taxpayers to prepare and maintain contemporaneous transfer pricing documentation for related-party transactions unless such transactions fall within one of five specified exclusion situations. One exclusion applies where the value of the related-party transactions does not exceed specified thresholds.

By way of a footnote in this latest Edn TPG, the IRAS has required that strict pass-through costs be included in the computation of the amount of related-party transactions when determining if the threshold is met for preparing contemporaneous transfer pricing documentation for the transactions. Although the IRAS may have viewed this as a clarification from its perspective, the requirement would cause concerns to taxpayers that might not have performed the computation in this way in previous years. It is hoped that the IRAS takes a reasonable approach in administering this aspect in such cases.

Further thoughts for taxpayers in Singapore

These developments provide further insights into a number of policy considerations that Singapore is balancing at this moment. Firstly, the finalization of the OECD BEPS Action Plan has put pressure on many tax authorities globally (including IRAS) to adopt appropriate legislation and implementation guidance intended to effectuate enforcement of these principles. As part of Singapore's commitment to implementing the four minimum standards under the BEPS Inclusive Framework, transfer pricing is a key aspect.

We had earlier discussed some of the practical difficulties in applying the arm's-length principle with respect to segregation of functions, assets, and risks across MNE groups. Taxpayers should appreciate opportunities to engage the IRAS upfront on these challenging issues early in the process as part of appropriate platforms (to be) made available to taxpayers. Pressure will be on taxpayers to have robust tax and transfer pricing policies, appropriate transfer pricing documentation, and relevant supporting documentation as part of this process.

At the same time, we believe taxpayers should welcome some of the administrative clarification and simplification, in particular the introduction of indicative margins for intercompany loans. This is aligned with the contemporaneous transfer pricing documentation requirement and should help ease the administrative burden for some taxpayers in complying with the arm's-length principle, assuming the IRAS administers these aspects in a practical manner.

We expect that the IRAS, like other tax authorities, will continue to step up enforcement of the arm's-length principle. For example, from the Year of Assessment 2018 (relating to financial year ending in 2017), the IRAS will introduce a new reporting requirement for companies that engage in related-party transactions that exceed specified value thresholds, in order to better assess companies' transfer pricing risks and improve the enforcement of the arm's-length principle.

Taxpayers should have in place robust tax and transfer pricing policies, appropriate transfer pricing documentation, and relevant supporting documentation to address cross-border tax risks as part of their good corporate governance. Taxpayers also should increasingly consider dispute prevention measures such as bilateral APAs to better manage potential double taxation exposure.

Taxpayers particularly should note the schedule set out by the IRAS to engage in exchange of information on cross-border unilateral APAs. Based on the schedule, unilateral APAs issued in periods prior to April 1, 2017 may be shared by the IRAS with the relevant foreign tax authorities by December 31, 2017. Taxpayers should take steps to review any existing unilateral APAs they have and assess the implications arising from this development.

The takeaway

The 4th Edn TPG marks the third round of updates to Singapore TPG in two years to clarify and incorporate transfer pricing and related aspects intended to better align with BEPS developments. The spelling out of the framework and schedule for exchange of information on cross-border unilateral APAs marks a further step taken by Singapore in fulfilling its commitment towards tax transparency, subject to robust measures being in place to safeguard the confidentiality of taxpayers' information. Given these and other international tax developments, taxpayers should brace themselves for increasingly stringent enforcement of transfer pricing aspects by tax authorities around the world.

Endnotes

1. 4th Edn TPG: Section 5.1.
2. 4th Edn TPG: Sections 5.20 -22.
3. 4th Edn TPG: Section 5.23.
4. 4th Edn TPG: Section 6.9.
5. 4th Edn TPG: Section 6.11.
6. 4th Edn TPG: Section 8.13. `
7. 4th Edn TPG: Sections 6.19(d) and 13.27 - 13.35.
8. 4th Edn TPG: Section 8.35.
9. 4th Edn TPG: Section 8.35.
10. 4th Edn TPG: Section 8.36.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

PwC Singapore

Paul Lau
Financial Services
+65 6236 3733
paul.st.lau@sg.pwc.com

Nicole Fung
Transfer Pricing Leader
+65 6236 3618
nicole.fung@sg.pwc.com

Sui Fun Chai
Tax Controversy and Dispute Resolution Leader
+65 6236 3758
sui.fun.chai@sg.pwc.com

Falgun Thakkar
Transfer Pricing
+65 6236 3618
falgun.d.thakkar@sg.pwc.com

Tan Hui Cheng
Financial Services
+65 6236 7557
hui.cheng.tan@sg.pwc.com

Vivienne Junzhao Ong
Transfer Pricing
+65 6236 4323
vivienne.junzhao.ong@sg.pwc.com

Lynn Tay
Financial Services
+65 6236 3645
lynn.tay@sg.pwc.com

Transfer Pricing Global and US Leaders

Isabel Verlinden, *Brussels*
Global Transfer Pricing Leader
+32 2 710 44 22
isabel.verlinden@be.pwc.com

Horacio Peña, *New York*
US Transfer Pricing Leader
+1 646 471 1957
horacio.pena@us.pwc.com

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