

Singapore's latest Transfer Pricing Guidelines released on 12 January 2017 incorporate further BEPS Actions developments

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The Inland Revenue Authority of Singapore (“IRAS”) released its 4th edition **Transfer Pricing Guidelines (“4th Edn TPG”)** on 12 January 2017. This 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 (OECD)’s BEPS¹ initiative.

In a nutshell

In its latest 4th Edn TPG, besides clarifying or elaborating on certain aspects of the guidance given in the previous edition, the IRAS has also explicitly incorporated Singapore’s position on TP-related aspects to align 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 16 June 2016 as well as other BEPS developments.

The key messages from the updates in the 4th Edn TPG are set out below.

- 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 guidance²;
- IRAS has re-emphasized the importance of robust functional analysis as part of the TP documentation, and provided additional guidance on how risk assumption is to be considered under the arm’s length principle. In gist, to assume a risk for TP purposes, a taxpayer needs to control the risk and has 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 are also provided³;
- 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 transactions⁴;

¹ Base Erosion and Profit Shifting

² 4th Edn TPG: Section 5.1.

³ 4th Edn TPG: Sections 5.20 -22.

⁴ 4th Edn TPG: Section 5.23.

- The IRAS has aligned its TPG with the IRAS' **e-Tax Guide on Country-by-Country Reporting** issued on 10 October 2016⁵ by incorporating the obligation of the ultimate parent entity of a Singapore multinational enterprise ("MNE") group to file a Country-by-Country Report ("CBCR"), if the reporting threshold is met. This is in addition to complying with contemporaneous TP documentation requirement;
- The IRAS now additionally requires a copy of the existing unilateral and bilateral/multilateral advance pricing arrangements and other tax rulings to which IRAS is not a party and which are related to related party transactions subject to transfer pricing documentation in Singapore, to be included in the documentation⁶. 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 2015⁷ ("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 under specified situations;
- The IRAS has for the first time 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, to be applied to an appropriate base reference rate, to facilitate compliance with the arm's length principle in respect of such transactions⁸;
- The IRAS has, among various updates to its guidance on Mutual Agreement Procedures ("MAP") and Advance Pricing Agreements ("APAs"), 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 audit⁹; and
- 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 TP documentation for the transactions.

We discuss below the implications of these latest developments.

Implications

(I) Ensuring appropriate profit allocation in line with substance, value creation and commercial realities

The MOF and the IRAS have explicitly 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, it has included additional guidance on how the IRAS will view the concept of risk assumption as part of the functional, asset and risk characterisation

⁵ 4th Edn TPG: Section 6.9

⁶ 4th Edn TPG: Section 6.11

⁷ 4th Edn TPG: Section 8.13.

⁸ 4th Edn TPG: Section 6.19(d) and 13.27 to 13.35

⁹ 4th Edn TPG: Section 8.35.

in an intercompany transaction. Put simply, the IRAS expects that where risks as 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 profile and documentary evidence it expects to evaluate risks assumed, which is to be considered as part of a taxpayer's contemporaneous TP documentation obligations in Singapore.

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

With these updates, taxpayers that enter into transactions with group entities will need to (re)consider current TP documentation efforts to better articulate these considerations and supporting documentation needed to practically demonstrate such fact pattern to the IRAS. In particular, where MNE groups encounter outcomes that appear to differ from those established by economic analysis, particular attention will need to be paid to demonstrate the facts and circumstances for such differences (e.g., operating conditions, options realistically available, other commercial specifics) and document these considerations appropriately.

The focus on aspects of risk recognition is a key concept that is admittedly, challenging to apply in practice. Many MNE groups may for various legitimate commercial and risk management reasons, choose to conduct different aspects of their functional activities, asset ownership and risk assumption activities within different affiliates. From this perspective, whilst the principles may be clear, when applied to the diverse specific facts and circumstances on these MNE groups, they may result in complex analyses and/or be subject to different interpretation by different parties. On this note, a MNE group will need to (re)assess in greater depth the issues around segregation of functions, assets and risks in different territories and clearly articulate its view on the relative importance of these aspects with respect to its specific fact pattern, in a robust manner.

MNE groups will also need to more comprehensively consider whether to document these on an ex post or an ex ante basis, as part of contemporaneous TP documentation or other supporting documentary evidence. Either way, we recommend that MNE groups bring forward their process for maintaining robust TP documentation on an up-to-date basis. Certainly, a more "real-time" documentation approach will cut down the hassle of searching for supporting evidence long after the transaction has been executed.

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

Whilst some taxpayers may consider these developments to impose excessive obligations and compliance burden, many will also note that these developments are not unique to Singapore or more onerous than those elsewhere. These developments come at the back of the need for IRAS to balance the need to secure our tax base and ensuring that Singapore is not used as an intermediary for facilitating BEPS activities through the robust application of the arm's length principle.

(II) Update MAP and APA guidelines

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

In the latest 4th Edn TPG, aside from a number of administrative updates and clarifications, the IRAS has explicitly articulated the following considerations:

- That “Taxpayers must also recognise that if they choose to accept a TP 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”¹⁰.

While the above does not represent a new position of the IRAS, the explicit articulation of the position by the IRAS in the 4th Edn TPG serves to remind taxpayers against making unilateral settlement efforts of any form as these will jeopardise the IRAS' negotiation efforts with other competent authorities to eliminate double taxation resulting from transfer pricing adjustments. Accordingly, if a taxpayer were to attempt to do this, it may have to live with double taxation consequences. In appropriate cases, it is possible they 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.

Taxpayers should therefore consider their dispute resolution strategy and start engaging IRAS earlier in the dispute resolution process. Whilst bilateral government to government discussions may at first sight, be more time consuming and require more resources, having such bilateral discussions will be beneficial in securing a more balanced and considered outcome. In addition, once the MAP process is in place, taxpayers should allow the competent authorities concerned to resolve the dispute through due process. Whilst taxpayers should facilitate the competent authorities in their negotiation with robust and prompt information support, they must refrain from making efforts to settle the dispute with one or more competent authorities concurrently.

- 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.”¹¹

Again, this is not a new position of the IRAS. However, the articulation of the above 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.

¹⁰ 4th Edn TPG: section 8.35

¹¹ 4th Edn TPG: section 8.36

(III) Disclosure of unilateral APAs in TP 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 TP documentation, the IRAS has set out for the first time its requirement that taxpayers include in their contemporaneous TP documentation, a copy of the existing unilateral and bilateral / multilateral APAs and other tax rulings to which the IRAS is not a party and which are related to related party transactions subject to the TP documentation.

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

(a) Jurisdictions of residence of all related parties with whom the taxpayer enters into transactions that are covered by the unilateral APAs; and

(b) Jurisdictions of residence of the taxpayer's ultimate parent entity and the immediate parent entity

provided that these jurisdictions:

(a) Have a tax treaty or exchange of information instrument with Singapore;

(b) Have the necessary legal framework and safeguards to ensure confidentiality and appropriate use of the information exchanged; and

(c) 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.

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

Unilateral APAs	Information to be exchanged by
<ul style="list-style-type: none">• Issued on or after 1 January 2012 and still in effect on 1 January 2015• Issued on or after 1 January 2015 but before 1 April 2017	By December 2017
<ul style="list-style-type: none">• Issued on or after 1 April 2017	Within three months after date of agreement

The exchange of past rulings is 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).

Unlike 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 is appropriate as such exchange of information should be governed by the provisions of the relevant tax treaties. In comparison, however, it suggests that the scope of exchange of information for unilateral APAs is broader than that for bilateral / multilateral APAs and this may lead to unforeseen consequences that may need to be managed by a MNE group. MNE groups should therefore consider the implications of the latest developments in determining their dispute prevention strategy going forward.

In conjunction with CbCR developments which 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 further level of detail of the group's overall tax and transfer pricing model.

Arising from these developments, it becomes even more important that taxpayers take steps to ensure a coherent and consistent tax and TP model in line with business and commercial reality, is deployed and implemented in accordance with the arm's length principle. More than ever before, tax authorities will have access to even more information to assess the adequacy of TP models and tax structures. Taxpayers will need to be conscious of this when planning and supporting their tax models - in line with operational substance and commercial realities.

(IV) Introduction of indicative margins for intercompany loans

To facilitate compliance with the arm's length principle, the IRAS has for the first time introduced indicative margin which taxpayers may apply on their related party loans obtained or provided from 1 January 2017 onwards, provided that the loan quantum 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 year¹².

The indicative margin, to be applied to an appropriate base reference rate, is not mandatory but merely 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 loan, 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, as applied to an appropriate base reference rate, but should support the margin adopted with robust transfer pricing analysis and documentation.

In terms of applying the indicative margin, 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).

¹² The indicative margin published on the IRAS website applicable for the period 1 January 2017 to 31 December 2017 is +250 bp (2.5%). This indicative margin may apply to related party loans not exceeding S\$15 million obtained or provided during the period.

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.

The loan threshold for applying the indicative margin approach is aligned with the safe harbour threshold under which the preparation of contemporaneous TP documentation for related party loans is not expected. Although contemporaneous TP documentation is not expected for related party loans not more than the equivalent of S\$15 million, a taxpayer is still required to 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 who wish to charge an appropriate interest rate that is acceptable to the IRAS from a Singapore transfer pricing perspective without having to undertake an elaborate transfer pricing analysis.

With this development, taxpayers who do not apply the indicative margin to the appropriate base reference rate, may now potentially find themselves having to defend the arm's length nature of the interest charged. This is because IRAS officers may in practice be guided by the indicative margin in their enforcement of the arm's length principle and question the basis of the interest rate(s) for such related party loans. In addition, taxpayers should note that whilst 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, they should consider their own (implied) credit rating, as well as other features of the loans (e.g. duration, call features etc.) 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 1 January 2017 onwards. The approach does not apply to eligible related party loans obtained or provided prior to 1 January 2017. In any case, there is no indicative margin published by the IRAS for periods prior to 1 January 2017. As such, 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 TP documentation for these loans.

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

(V) Determination of threshold of related party transactions for which contemporaneous TP documentation should be maintained

The IRAS expects taxpayers to prepare and maintain contemporaneous TP documentation for related party transactions unless such transactions fall within one of the five exclusion situations specified. One of these exclusion situations is where value of the related party transactions do 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 for the purpose of determining if the threshold is met for which taxpayers are expected to prepare and maintain contemporaneous TP documentation for the transactions. Whilst the IRAS may likely have viewed this as a clarification from its perspective, the requirement would cause concerns to taxpayers who might not have done computation in this way in previous years to assess the need to prepare contemporaneous TP documentation for their related party transactions. It is hoped that the IRAS would be reasonable 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 the 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 implement the appropriate legislation and implementation guidance to ensure 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. We believe it goes without saying that taxpayers should appreciate opportunities to engage the IRAS upfront on these challenging issues early on in the process as part of appropriate platforms (to be) made available to taxpayers. Pressure will be on taxpayers to have robust tax and TP policies, appropriate TP documentation and relevant supporting documentation as part of this process.

Notwithstanding this, taxpayers should also welcome some of the administrative clarification and simplification, in particular around the introduction of administrative measures around indicative margins for intercompany loans. This is aligned with the contemporaneous TP documentation requirement and will no doubt help ease the administrative burden on taxpayers to varying extent in complying with the arm's length principle if the IRAS were to also administer these aspects in a practical manner.

The 4th Edn TPG marks the third round of update to Singapore TPG in 2 years to clarify and incorporate TP and related aspects that 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 must brace themselves for increasingly stringent enforcement of TP aspects by tax authorities around the world.

We expect that the IRAS, like other tax authorities, will continue to step up enforcement of the arm's length principle to protect Singapore tax base in a responsible manner. 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 which engage in related party transactions that exceed specified value thresholds, in order to gain better assessment of companies' transfer pricing risks and ***improve*** on the enforcement of the arm's length requirement.

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

In addition, taxpayers should particularly 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 1 April 2017 may be shared by the IRAS with the relevant foreign tax authorities by 31 December 2017. Taxpayers should take steps to review any existing unilateral APAs that they have and assess the implications arising from this development.

Anything else?

For more information on how the broader BEPS initiative will affect businesses in Singapore, please refer to our earlier communications:

- [Summary of impact of OECD BEPS Action Points on Singapore \[16 Oct 2014\]](#)
- [Observations on the finalization of the OECD BEPS project \[3 Nov 2015\]](#)
- [A new chapter in Singapore's Transfer Pricing regime introducing contemporaneous TP documentation rules \[2nd Edn TPG - 12 Jan 2015\]](#)
- [Singapore tax authorities tighten APA process in latest Transfer Pricing Guidelines \[3rd Edn TPG - 7 Jan 2016\]](#)
- [Singapore tax authorities issue long-awaited Singapore Country-by-Country Reporting \(CbCR\) implementation guidance \[11 Oct 2016\]](#)

Your PwC contacts

If you would like to discuss the impact of these developments on your group's affairs, please feel free to reach out to any of the facilitators or your local PwC Contact.

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