IRAS Updates Transfer Pricing Guidance on Related Party Loans In Light of IBOR Transition

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Background

To facilitate compliance with the arm's length principle, IRAS has, since 2017, put in place yearly indicative margins which taxpayers can apply on each of their related party loans not exceeding S$15 million, to approximate an arm's length interest rate for that loan. This is done by adding the IRAS' indicative margin to the appropriate base reference rate. Taxpayers who choose not to apply the indicative margin will have to undertake transfer pricing analysis to determine the appropriate arm's length interest rate.

From 2017 to 2021, the IRAS has published the indicative margins at the beginning of each calendar year and based on Interbank Offered Rates ("IBORs") as base reference rates such as the Singapore Swap Offer Rate ("SOR") and Singapore Inter Bank Offered Rate ("SIBOR").

IBOR transition and updated guidance

International regulators have announced that the US Dollar London IBOR ("USD LIBOR") will be discontinued after 30 June 2023. In line with the global interest rate benchmark reform, the SOR and SIBOR will also be discontinued in phases, by 31 December 2024. To prepare for the discontinuation of SOR and SIBOR, all Singapore financial institutions have ceased usage of SOR and SIBOR in new loans. To support a smooth transition, the Association of Banks in Singapore and the Singapore Foreign Exchange Market Committee ("ABS-SFEMC") had earlier identified the Singapore Overnight Rate Average ("SORA") to replace SOR and SIBOR as the key interest rate benchmark for use in Singapore Dollar financial instruments such as loans.

IRAS has updated their website for the indicative margin to be applied for related party loans obtained or provided in 2022 as follows:

Related party loan not exceeding S$15 million obtained or provided during the period	Indicative Margin applicable to Risk-Free Rate ("RFR")
1 January 2022 to 31 December 2022	+180 bps (1.80%)

To note, the indicative margin is now **to be applied on the appropriate RFR** as base reference rates, rather than on IBOR base reference rates.

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Illustration:

Taxpayer A provides a floating rate loan of S$10 million to its related party on 1 March 2022 and decides to adopt 3-Month SORA as the base reference rate. Applying the IRAS' indicative margin, the interest rate for the related party loan will be 1.80% plus the 3-Month SORA rate.

What does the updated guidance mean for Singapore taxpayers?

Taxpayers currently applying the indicative margin to price related party loans must now adopt the updated guidance provided by IRAS and use the appropriate RFR as the base reference rate. If there are legacy IBOR loans, they must be converted to RFR loans before the IBORs are decommissioned. Conversion must be made based on the guidance issued by the relevant governing bodies for the relevant IBOR/RFR pairs. For example, if taxpayers are transitioning from legacy SOR loans to SORA loans, they can refer to the Report on Recommendation for Transition of Legacy SOR Contracts issued on 29 July 2021 by the Steering Committee, which recommends as a broad principle to use SOR-SORA basis swap pricing.

Taxpayers that continue to use IBORs during FY 2022 will not be eligible to apply the indicative margin, and will be expected to prepare the necessary transfer pricing analysis to substantiate the arm's length interest rates.

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