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## Singapore Issues Updated Transfer Pricing Guidelines

### Overview

On 12 January 2017, the Inland Revenue Authority of Singapore (IRAS) issued fourth edition of the transfer pricing guidelines. The revised edition largely reflects Singapore's commitment back in 2016 to implement the four minimum standards of the 15-action plan under OECD's Base Erosion and Profit Shifting (BEPS) project.

### Key changes

#### Arm's length principle

The revised guidance supports the BEPS principle that profits should be taxed where the real economic activities generating the profits are performed and where value is created. It sought to achieve profit allocation to locations where real functions are performed compared to profit allocations on mere contractual risk allocation and legal ownership of intangibles.

Going forward, taxpayer should ensure that profits follow functions and value creation to ensure adoption of the revised arm's length principle for related party transactions by revisiting their existing structures and profit allocations.

#### Risk allocation

The profit distribution between related parties is dependent on the functions each enterprise performs taking into account assets used and risks assumed. The new guidelines now devote three pages on risks analysis compared to a short paragraph under the earlier guidelines. Risks are the effect of an uncertainty on the objectives of the business. The actual assumption of risks by a taxpayer to a transaction can significantly affect the pricing of that transaction at arm's length. Accordingly, when analysing risks under the revised guidelines, taxpayers should consider:

- a) The effect of the risks assumed though not apparent on the financial statements;
- b) Risk assumption vis-à-vis risk management – a taxpayer who assumes a risk is entitled to the upside benefits and incurs the downside costs with the result that the party assuming a risk will also bear the financial and other consequences if the risk materialises; whereas risk management should not be thought of as necessarily encompassing a separate function, requiring separate remuneration, distinct from the performance of the activities that optimise profits;
- c) To assume a risk for transfer pricing purposes, the taxpayer needs to control the risk and has the financial capacity to assume the risk.

### Safe harbour for inter-company loan transactions

The revised guidelines have introduced a safe harbour in the form of an "indicative margin" to price related party loans obtained or provided from 1 January 2017. The indicative margin can be applied to an appropriate base reference rate such as swap rate or Singapore Government Securities yield for fixed rate loans or SIBOR and LIBOR for floating rate loans.

IRAS will publish the indicative margin on its website and will be updated at the beginning of each year for taxpayers to price their Singapore-dollar denominated and foreign currency denominated loans. For loans denominated in foreign currency, the Singapore dollar threshold of S\$15 million is to be determined based on the prevailing exchange rate at the time the loans are obtained or provided.

Taxpayers can choose to apply the indicative margin to each related party loan that does not exceed S\$15 million at the time the loan is obtained or provided. The threshold is based on the loan committed and not the loan utilised. Accordingly, if a taxpayer obtained a loan facility of S\$18 million from a related party; the safe harbour of an indicative margin cannot be applied notwithstanding that the amount utilised or intended to be utilised is less than S\$15 million.

Once the taxpayer has opted for the safe harbour of indicative margin to price related party loans, then they are not expected to prepare transfer pricing documentation to justify the arm's length rate for those loans. However, the application of indicative margin is not compulsory and taxpayers are free to adopt a margin that is different from the indicative margin by performing a detailed transfer pricing analysis.

### Documentation thresholds - Guarantees

Guarantee income and guarantee expense has been included within the "others" category along with service income/expense, royalty income/ expense and rental income/ expense. The threshold for this "others" category is S\$1 million.

Though, guarantee income/expense has been included within the "others" category, there is no definition provided within the guidelines to the term "guarantee" as to whether it only refers to explicit guarantee or implicit guarantee or both. In addition, there is no safe harbour provided unlike the indicative margin for related party loan transactions and the detailed steps on undertaking comparability analysis for guarantee transactions is also not provided. With these missing, we expect a fair deal of controversy on the guarantees front and therefore a clarification from IRAS will be much welcomed by the taxpayers.

Further, a clarification is now included that strict pass through costs should also be included in the computation to determine if the thresholds are breached and therefore whether there is an obligation to prepare a transfer pricing documentation.

### Miscellaneous

In order to implement Singapore's commitment to one of the four minimum standards of the 15 point action plan under the BEPS project – Countering harmful tax practices, Action 5 – IRAS will spontaneously exchange information on cross border unilateral APAs within three months after date of agreement (for unilateral APAs issued on or after 1 April 2017) and by December 2017 (for unilateral APAs issued before 1 April 2017). The unilateral APAs will be exchanged, subject to satisfaction of certain safeguards, 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.

### Key takeaways

Under the revised arm's length principle, taxpayers will have to demonstrate where real economic activities generating profits are performed and where value is created compared to a contractual separation of risks and intangibles from functions. At the same

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time, taxpayers should be mindful of which entity within the group assumes risks compared to an entity performing risk management given that only the former is entitled to upside benefits.

Further, with the introduction of a safe harbour for related party loans, IRAS has struck a fine balance in ensuring that the arm's length principle is applied for related party transactions whilst keeping the overall costs of compliance low and helping taxpayers in these difficult times.

All in all, the revised guidelines are a step in right direction which reflects Singapore's commitment to the BEPS project by ensuring that it provides world's most efficient and transparent business environment and is not seen as a tax haven despite its low corporate tax rate. Singapore does not condone harmful and abusive tax practices which undermines its sovereignty as the world's best place to do business which is protected through the subject guidelines.

Kindly contact us to understand further on how we can support you in riding this new wave of change.

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