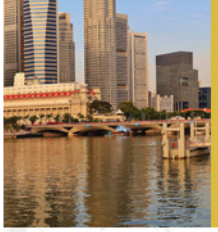
Singapore

SOWMYA VARADHARAJAN
Crowe Singapore
Director, Transfer Pricing Services
+65 6856 9950
sowmya@crowe.sg

Dr Sowmya Varadharajan has over 15 years of experience in designing, documenting and defending intercompany transactions. Having been trained in the US on international tax and transfer pricing issues through blue-chip corporations, she now applies her training to transfer pricing issues in the Asia-Pacific region. She has published numerous articles on transfer pricing topics in regional newspapers as well as other technical publications and is the author of *Transfer Pricing in Singapore,* published by Wolters Kluwer. She frequently presents at conferences organised by the Singapore Accountancy Academy, Wolters Kluwer and various other transfer pricing events regionally.

Q. What do you consider to be the most significant transfer pricing changes or developments to have taken place in Singapore over the past 12 months or so?

VARADHARAJAN: There have been a number of key transfer pricing developments in Singapore of late. Given the importance of the commodity industry to Singapore, the Inland Revenue Authority of Singapore (IRAS) has built on guidance from the Organisation for Economic Co-operation and Development (OECD) and issued its own guidelines for commodity marketing and trading activities in May 2019. In line with recent developments globally and regionally, the IRAS has clarified that it requires all intercompany loans, either domestic or cross-border, to be compliant with the arm's length principle. As foreign sourced interest income is only taxed in Singapore upon remittance, it is possible for Singapore taxpayers to offer interest-free loans. Thus, this clarification from IRAS is much needed. Crucially, on 8 September 2020, IRAS provided initial guidance on how transfer pricing analysis and documentation should be prepared in light of COVID-19. A robust analysis of various elements, such as changes in function, asset risk analysis, changes in contractual terms and an understanding of how the industry has been affected by COVID-19 will be required to substantiate the



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arm's length nature of the transfer prices. In addition, the IRAS has also noted that it will be possible for taxpayers to use three years for the tested party only for Year of Assessment 2021 in supporting the results of the taxpayer.

Q. In your opinion, do companies pay enough attention to the challenges and complexities of maintaining compliant transfer pricing policies?

VARADHARAJAN: Considering global and regional tax developments, companies that operate on a cross-border basis are increasingly aware of their obligations from a transfer pricing documentation perspective. In addition, they recognise the need to ensure that the transactions adhere to the arm's length standard. However, this knowledge does not necessarily translate into action for smaller multinational enterprises (MNEs) operating on a regional basis. A key stumbling block is cost as the preparation of transfer pricing analysis and documentation is typically more expensive than tax return compliance. This results in a 'wait and see' approach. With respect to larger MNEs, transfer pricing compliance is less of an issue. Rather, these companies are focused on designing consistent transfer pricing policies across their entities, and in trying to manage any variation in profit outcomes, and, if possible, tax optimisation, which has become increasingly hard in the post-base erosion and profit shifting (BEPS) world.

Q. To what extent have the tax authorities in Singapore placed greater importance on the issue of transfer pricing in recent years, and increased their monitoring and enforcement activities?

VARADHARAJAN: Although transfer pricing has been around since 2006, when the first transfer pricing guidelines were introduced, it gained traction in Singapore in 2015 when the transfer pricing guidance was substantially revamped, to introduce contemporaneous transfer pricing documentation. This change was due to OECD developments on Action Plan 13. In 2017, Sections 34D, 34E and 34F were legislated in the Singapore Income Tax Act. Section 34D redefined the arm's length standard and provided IRAS with the power to reconstruct transactions where it can be shown that the form of the transaction is different to the substance of the transaction and where third parties may have entered into transactions under different terms, conditions and pricing structures.

Section 34E introduced a transfer pricing penalty and surcharge while Section 34F legislated the need for contemporaneous, annual transfer pricing documentation with effect from Year of Assessment 2019 – that is, financial year 2018. As a result of these changes, the IRAS has been scrutinising related-party transactions. Even if taxpayers are exempted from complying with Section 34F, the IRAS implicitly encourages them to do so to better manage their transfer pricing risks.

Q. Have you seen an increase in transfer pricing disputes between companies and tax authorities in Singapore?

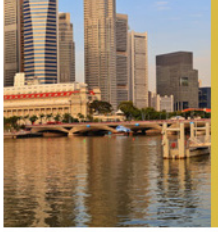
VARADHARAJAN: There has definitely been an increase in TP disputes in Singapore, and the region in recent years.

Q. How should companies respond if they become the subject of a tax audit or investigation? What documentation needs to be made available in this event?

VARADHARAJAN: Although transfer pricing documentation was only legislated with effect from the Year of Assessment 2019 onward, transfer pricing documentation can be requested for any of the audit years. Upon reading the transfer pricing reports, the IRAS will typically ask for additional information to, first, explain the taxpayer's or related party's business model, and the typical practices and norms experienced in its industry, second, to clarify the inter-company flows and the functional profiles of the relevant entities in the related-party transactions and, third, to describe, in detail, the pricing of related-party transactions, in particular explaining in plain language the pricing process using actual executed transactions conducted by the taxpayer. Merely providing the transfer pricing documentation is not enough. It is necessary to provide other documents outlining the price setting, the operational aspects of transfer pricing, such as a summary of meetings, email trails, sales and purchase contracts, as evidence to show their capacity to make decisions or to exercise authority.

Q. What kinds of challenges arise in calculating appropriate transfer prices, both for tangible and intangible assets? How crucial is it to have consistent supporting documentation?

VARADHARAJAN: Most organisations have an approach to calculate their transfer prices, based on input from business, as well as an analysis of comparable data. However, where there are external shocks, such as the COVID-19 pandemic, it may not be possible to identify at the end of the year if the results were recorded, because of incorrect transfer pricing or because of the external shocks. Thus, it is necessary to prepare the required analysis and documentation to support the various arguments made by the taxpayer. Where intangibles are transferred or licenced between related parties, a valuation needs to be performed to determine the value of the intangible asset. The most common valuation approach tends to be the income-based method. This can raise questions around the validity of income projections, particularly in the current market and economic situation. Where intangibles are licenced, the royalty rate is typically based on the revenues earned. If revenues drop, the group needs to understand the impact on both the licensor and licensee.



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Q. In general, what advice would you give to companies on reviewing and amending their transfer pricing policies and structures?

VARADHARAJAN: Using a basic transfer pricing governance framework, it is necessary to first determine the 'as-is' transfer pricing compliance culture, documentation and views. The governance framework will establish the right structure to review or modify the transfer prices in respect of existing transactions. In addition, it will outline the people responsible for monitoring transfer prices. Buy-in from front-line employees is required to notify of the potential implementation of new or adjusted inter-company transactions.

In our experience, we are aware of situations where procurement or sales managers engage with related parties on an ad hoc basis to buy or sell products. Commissions or fees may be paid by one business unit to another for support provided. Such transactions are often decided by commercial personnel with little involvement of the finance or tax teams. In many cases, this issue only comes up during quarterly or year-end reporting when the finance team is looking at the financial impact of business operations, which is often too late to make any changes. Inadequate attention to general transfer pricing governance and compliance is generally identified as a risk factor warranting a higher level of scrutiny by the IRAS and tax authorities in other jurisdictions. ■

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SOWMYA VARADHARAJAN
Director, Transfer Pricing Services
+65 6856 9950
sowmya@crowe.sg

SIVAKUMAR SARAVAN
Senior Partner
+65 6856 9993
siva.saravan@crowe.sg

KIN MENG LIEW
Associate Director
+65 6856 9933
kinmeng.liew@crowe.sg