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Reading the tea leaves: What does the Singapore TP landscape hold for 2021?

Sivakumar Saravan and Sowmya Varadharajan of Crowe Singapore explore the changes and challenges that taxpayers can anticipate over the coming year.

2020 will probably be remembered primarily for COVID-19 as governments, businesses and individuals alike dealt with the fall-out from the pandemic. However, in the world of transfer pricing (TP), there were some significant developments as well. These include the issuance of the 'Transfer Pricing Guidance on Financial Transactions' by the OECD and substantial progress on pillar one and pillar two proposals by the OECD/G20 Inclusive Framework.

From a Singapore TP perspective, there were two main TP related developments. The first was the issuance of guidance related to transactions impacted by COVID-19. Thereafter, in November 2020, the Inland Revenue Authority of Singapore (IRAS) also issued guidance on how TP adjustments will be treated from a goods and services tax perspective.

Against this backdrop, what can taxpayers expect for 2021 from a Singapore TP perspective?

COVID-19 and TP documentation

There will be a continued focus on the impact of COVID-19 for both taxpayers and the IRAS. The initial TP guidance provided by IRAS centred around the following:

- What information should be included in TP documentation to support TP outcomes for businesses affected by COVID-19;
- The use of multiple-year data (called term testing) to spread out the impact of COVID-19 over a longer period; and
- The ability to file a new advanced pricing agreement (APA) or request for renewal of an existing APA during the COVID-19 period.

The OECD guidance, on the other hand, looks at broader issues such as how comparability analysis should be carried out, how risks should be allocated between parties, etc. As IRAS reviews the OECD TP guidance, it is likely that further clarifications and guidance will be provided by IRAS in the months ahead. For example, on January 29 2021, IRAS issued three additional frequently asked questions to provide clarity on the following:

a) Can grants received from the government be shared with related parties;
b) Whether limited risk distributors can make losses; and
c) Whether loss making companies be included in the comparability analysis.

Such guidance, has and will, provide clarity to taxpayers in preparing appropriate and adequate TP documentation for financial year (FY) 2020.

Given the level of fiscal support provided by the Singapore government to help businesses weather the impact of COVID-19, it is reasonable to expect an increased level of scrutiny in all tax matters, including transfer pricing. Keeping in mind the guidance that both OECD and IRAS have provided for demonstrating that the results recorded in FY 2020 are consistent with the arm's-length standard, Singapore taxpayers should pay close attention to the way in which TP documentation reports are prepared for FY 2020.

Many tax authorities, including the IRAS, have noted that COVID-19 cannot be used as an 'excuse' to support operating losses. Rather a careful analysis should be undertaken to outline the specific impact that COVID-19 has had on taxpayers' operations.

As such, a careful analysis of the impact of COVID-19 should be included, with a robust function asset and risk analysis to support any changes in TP outcomes pre- and post- COVID-19. As appropriate comparable data is not likely to be available when the TP documentation is prepared, Singapore taxpayers should attempt to show, through qualitative analysis or anecdotal evidence, that the commercial and financial relations entered into by the Singapore taxpayer is broadly consistent with the arm's-length standard.

Secondary adjustments

Related to the issue of TP audits is the increased prevalence of secondary adjustments. This is a trend that has recently been noticed, for example, in the audits carried out by the Indonesian tax office. The TP adjustment made by the foreign tax office is the primary adjustment, but this does not alter the fact that the excess profits represented by the adjustment are not consistent with the result that would have arisen if the controlled transactions had been undertaken on an arm's-length basis. Thus, a secondary adjustment is included to ensure that the actual allocation of profits is consistent with the primary adjustment.

For example, Company A, a resident of Country X, pays royalty of $10m to an overseas-related party Company B. The tax authorities in Country X adjust the arm's-length value of the transaction as $8m and hence, Company A is allowed a tax deduction for $8m only. However, since Company A has already paid $10m in cash to Company B, the accounting difference of $2m is deemed as dividends. Such secondary adjustments can result in double taxation.

Although the OECD Transfer Pricing Guidance allows for secondary adjustments, such adjustments were not typically applied in TP audits. However, they are increasingly becoming more commonplace.

The IRAS is aware of this issue faced by Singapore taxpayers due to secondary adjustments made by foreign tax authorities. Given the possibility of additional tax liabilities, it is recommended that Singapore taxpayers who face such secondary adjustments approach the IRAS for support and guidance.

Inter-company borrowings

For a related party loan not exceeding S$15 million (approximately $11.3 million), the IRAS has introduced a safe harbour indicative margin which taxpayers can apply as an alternative to performing detailed TP analysis to comply with the arm's-length principle.

IRAS has indicated a safe harbour margin of 2.75% for related party loans not exceeding S$15 million obtained or provided during the year 2021. This is higher than its earlier margins for the years 2017 to 2020. The reason(s) for this increase is not clear, given that interest rates on an overall basis are on a downward trend. It could be an indication that IRAS expects the effective loan interest rate to be around 3.5% in line with prior years. It is also possible that the increased margin is reflective of the continued economic uncertainty which may lead to an overall decrease in the borrower's creditworthiness.

The increase in the safe harbour margin is likely to put pressure on cross border intercompany arrangements especially for companies that are using Singapore as a treasury centre for cash pooling. Lending at rates below the safe harbour margin will increase the need for contemporaneous TP documentation to support that the rates are at arm's length. On the other hand, applying the indicative margin by a Singapore lender may not be attractive for a regional borrower.

The other key change that taxpayers need to be aware of is the implications of the transition from an interbank offered rate (LIBOR), which will come to a closure by the end of 2021, to an overnight funding rate (SOFR).

Concluding remarks

It looks like 2021 will be a year with potential clarity on several unknowns. As such, taxpayers should continue to keep their ears on the ground and stay in touch with guidance provided by IRAS to help support and defend their TP arrangements.

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