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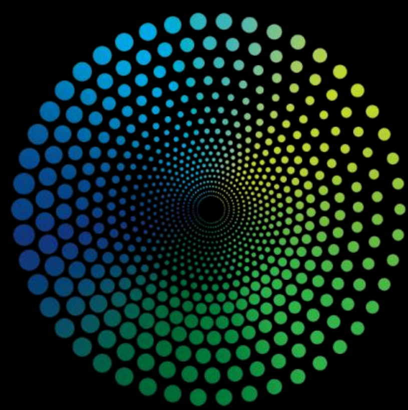

Singapore Transfer Pricing developments

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Greetings from your Tax & Legal team at Deloitte Singapore. We hope that you and your loved ones are staying safe and healthy despite these challenging times. As we navigate ourselves through this trying period, we are committed to giving you the support you need.

We are pleased to share the following with you.

IRAS releases guidance for taxpayers affected by COVID-19

The COVID-19 pandemic has dealt a crushing blow to the global economy resulting in an unprecedented and uncertain operating environment for businesses, tax administrations, and individuals. Governments have introduced a number of support measures to cushion the impact of COVID-19 on businesses that have suffered in the significant economic downturn. Tax administrations have also been agile and flexible in providing desirable and real-time guidance to businesses dealing with the impact of COVID-19.

In the Asia-Pacific region, the Australian Tax Office (ATO) and the New Zealand Inland Revenue (IR) proactively issued guidance for businesses to deal with the TP impact of COVID-19. Further, the Malaysia Inland Revenue Board (IRB) issued guidance on the impact of COVID-19 on Advance Pricing Agreements (APAs). Separately, the Organisation for Commercial and Economic Development (OECD) Working Party No. 6 has engaged in public consultations and is expected to publish guidance on TP issues arising in relation to COVID-19 before the end of the year.

In line with these global developments, the Inland Revenue Authority of Singapore (IRAS), on 7 September 2020, released on their website their initial guidance for taxpayers dealing with the impact of COVID-19 on their TP outcomes and related party arrangements (COVID-19 TP Guidance). Please click on the link below for more information.

More information

Key highlights

The IRAS acknowledges that COVID-19 has adversely impacted Singapore businesses and the current environment is not reflective of 'normal business conditions'. In an interactive Q&A format, the IRAS has provided insights to taxpayers on how to analyse, document and substantiate the impact of COVID-19 on their TP outcomes and related party arrangements. The IRAS has also extended a one-time special concession to taxpayers for Year of Assessment (YA) 2021, whereby multiple-year or term-testing approach can be applied to defend the taxpayer's TP outcomes. Additionally, the IRAS also recognises that COVID-19 and the underlying business uncertainty will impact the Advance Pricing Agreement (APA) process in Singapore and has accordingly issued procedural clarifications for taxpayers. The following sections discuss the clarification issued by the IRAS in detail:

- **TP documentation and substantiation of arm's length outcomes for businesses impacted by COVID-19**
  The information expected to be provided in the TP documentation of taxpayers affected by COVID-19 includes the following:

  - A broad analysis of how the taxpayer's industry has been affected by COVID-19 and the direct impact of COVID-19 on the company.
  - Documentation of who and which entity within the group made decisions relating to management of risks relating to COVID-19. This information will help to indicate which entities are in control of the decisions and thus should bear the related risks.
  - The functional analysis of the company and the related parties before and after COVID-19 (i.e., any re-allocation of functions, assets and risks, as well as any re-characterisation).
  - The contractual arrangements between the company and its related parties, highlighting whether any obligations or material terms and conditions have been varied, amended, or terminated in light of COVID-19.
  - A comparison of the budgeted (pre-COVID-19) and actual results of the profit and loss analysis of the company, providing explanation and evidence to support the variances.
  - Reasons and supporting evidence to justify how the company's profitability has been negatively impacted by COVID-19.
  - Details relating to COVID-19 specific government assistance that the company has received or government regulations imposed on the company which has an impact on its operations.

- **Concession to apply term-testing for YA 2021**
  The IRAS has proactively granted a one-time special concession to taxpayers whereby they can apply term-testing or multiple-year testing for YA 2021 (i.e., financial year [FY] 2020) without prior consultation with the IRAS. The guiding principles for the application of term-testing for YA 2021 are as follows:

  - The taxpayer is of the view that annual testing may lead to volatile results due to the impact of COVID-19 and that sufficient documentary evidences are maintained by the taxpayers to justify the volatility and adverse impact of COVID-19 in YA 2021;

- The TP documentation clarifies the approach adopted by the taxpayer for term-testing for YA 2021; and
- Term testing is highlighted as a one-off event in the TP documentation for YA 2021.

The IRAS has also clarified that term-testing may generally be applied over a period of three years and illustrated the application of term-testing by way of a numerical example. The concession available to the taxpayers can be explained as follows:

Taxpayer's margin for FY 2020 i.e., YA 2021: -6.67%
Taxpayer's term-tested weighted average margin for FY 2018 to FY 2020: 2.14%
'Nearest edge' of arm's length range: 3%

The TP adjustment for YA 2021 will be restricted to the difference between nearest edge of the arm's length range i.e., 3% and the three-year margin i.e., 2.14%. In the absence of term-testing, the taxpayer would have required to make a TP adjustment for the difference between the arm's length range i.e., 3% and the FY 2020 margin i.e., -6.67%. Hence, term-testing will reduce the quantum of TP adjustment for the taxpayers for YA 2021. Further, it appears that for YA 2021, the IRAS may accept TP adjustments made by the taxpayers to the tune of the 'nearest edge' of the arm's length range, i.e., the lower quartile, which will also minimise the quantum of TP adjustment for YA 2021.

The IRAS has advised taxpayers to take into account the corresponding impact of term-testing approach on their related parties. The IRAS has cautioned taxpayers that term-testing may not be allowed in certain overseas jurisdictions i.e., a similar concession may not be available to the related parties and TP disputes may arise.

- **COVID-19 and the impact on APAs–procedural clarifications**
  The IRAS is mindful that the uncertainty and disruption caused by COVID-19 will invariably have a material impact on the fundamental critical assumption of "business as usual" as well as other terms and conditions for taxpayers that have an APA in place or are contemplating or negotiating an APA with the IRAS. In fact, the IRAS has clarified its position that it is "open for business" if the taxpayer's operations are not impacted by COVID-19. However, where taxpayer's operations are significantly impacted by COVID-19, the IRAS has issued a set of procedural clarifications and actions that need to be undertaken by taxpayers to determine the viability of their ongoing or future APAs.

  - Procedural clarifications for taxpayers engaging in APA discussions with the IRAS without an agreed APA

    For fresh APA applications or renewals, the IRAS recommends taxpayers to engage in an early discussion to assess if it can move forward with the application or defer the application to a time when there is a greater level of certainty on the factors that impact the TP between the taxpayer and its related parties.

    For APAs under review and negotiation, the IRAS expects taxpayers to assess if there are any transfer pricing implications arising from COVID-19 which may impact the APA application (e.g., changes to critical assumptions, functional profile, financial projections) and proactively engage with the IRAS. If the taxpayer's business is significantly affected by COVID-19 and uncertainties are involved or anticipated, the IRAS has clarified that it may be difficult to progress the APA application and it may consider termination/postponement of the APA process with mutual consent.

- Procedural clarifications for taxpayers with an existing APA agreement with the IRAS

  The IRAS expects taxpayers to review and assess whether there is any breach of the critical assumptions, terms and conditions in the existing APA agreement as a result of COVID-19. In case of a breach, the taxpayer is expected to proactively notify the IRAS, provide an analysis of the impact as a result of COVID-19 and explain the reasons for the breach with a suggested next course of action. The IRAS will ultimately evaluate if:

  a. The APA will run its usual course; or
  b. The APA terms and conditions are modified; or
  c. The APA is suspended or terminated with mutual consent.

  In the case of any ongoing or existing Bilateral/Multilateral APAs, the IRAS will also discuss the case with the overseas Competent Authority and arrive at a mutually acceptable conclusion.

Deloitte Singapore's views

In light of the COVID-19 pandemic, business continuity, social responsibility, cost efficiency, liquidity management and building businesses that are ready for the 'next normal' have been top of the priority list on the Boardroom agenda for multinational enterprises (MNEs). Singapore is a strategic Asian regional headquarter (RHQ) for nearly half of the world's MNE groups. Singapore-based businesses usually engage in complex operational and transactional TP arrangements with their global headquarters (GHQs) and worldwide related parties. This trend is expected to continue during and after COVID-19.

Tax administrations across the globe are gearing up for a significant reduction in tax revenues due to the negative impact of COVID-19. In the post Base Erosion and Profit Shifting (BEPS) world, tax administrations have been undertaking a number of aggressive TP audits and scrutiny on MNE groups with a special focus on profits retained in locations such as Singapore. These actions are expected to intensify post COVID-19.

Hence, it is imperative for Singapore businesses and RHQs to work together with the GHQs and worldwide counterparts to assess and balance their global as well as local TP risks. Any lapses in addressing TP outcomes i.e. a one-sided approach may create double taxation risk for the MNEs, resulting in additional, unwarranted costs and negative financial impact on the group.

Therefore, the timing and urgency of release of the COVID-19 TP Guidance is very well received since it demonstrates the IRAS' commitment to proactively guide and support Singapore businesses. The IRAS has showcased its recognition of the immediate operational and other TP challenges faced by Singapore businesses in light of COVID-19. They have given Singapore taxpayers an opportunity and necessary ammunition to engage in TP discussions with GHQs and overseas related parties and make TP adjustments, if necessary, by the end of 2020.

TP documentation and substantiation

Taking cue from the IRAS guidance, as a first step, it would be crucial for MNE groups as well as the Singapore taxpayers to assess the areas which the IRAS has provided guidance. In addition to the Singapore assessment, MNEs should also consider the impact of potential realignment of supply chains, value creation and risk reallocation, guidance from any overseas tax authority, TP risks and audits in MNE locations, the group's forecasts and impact (for FY 2020 and beyond), as well as the relevance and viability of the group's TP policy and TP documentation positions.

Thereafter, Singapore taxpayers can conduct a strategic review of their TP policies and assess whether the existing TP policy should be reviewed on a short-term/temporary basis or long-term/permanent basis.

Subsequent to the analysis of the COVID-19 impact, associated TP risks and a strategic review of TP policies, taxpayers should create robust TP documentation which incorporates the areas that the IRAS has outlined in their COVID-19 Guidance in order to support the position determined as part the strategic review. In addition to this, taxpayers should maintain strong supporting evidences, material information and revise intercompany agreements and TP policies, etc., as necessary.

The above TP risk assessment would be also extremely helpful not only for Singapore taxpayers (e.g., queries, audits/investigations etc.) but also for the related parties that have transactions with the Singapore taxpayer. These assessments and supporting analyses will also help facilitate discussions with the overseas tax authorities and potentially foster the APA or Mutual Agreement Procedure (MAP) process.

Concession to apply term-testing for YA 2021

The IRAS is first in the region to introduce and clarify the term-testing approach. This is a positive step in line with the sentiment of the Singapore Government to prioritise the provision of necessary support and relief to Singapore taxpayers.

Typically, taxpayers are expected to undertake an annual testing of TP outcomes to analyse whether their TP arrangements with related parties meet the arm's length principle (ALP). The financial data of the comparable companies for the prior years is typically used to determine the arm's length range. As such, in order to improve comparability, in select cases, taxpayers undertake special factor adjustments (including any quantitative adjustments) to document their TP position in order to comply with the ALP. These adjustments are usually prone to questioning in the event of a TP audit due to their underlying subjectivity.

For FY 2020 (YA 2021) the IRAS recognises that single-year testing will be impacted by COVID-19 whereas the financial results of the selected comparable companies will not be reflective of COVID-19. Accordingly, it has extended a one-time concession to support Singapore taxpayers by allowing them to use term-testing for FY 2020 without a prior consultation with the IRAS. The concession will provide an additional (and relatively simple to apply) avenue to taxpayers to meet their ALP in FY 2020. The term-testing concession should not preclude taxpayers from other forms of substantiation that its profit outcome is arm's length for FY 2020, such as appropriate economic or econometric analysis.

It appears that term-testing may be applied in a scenario provided where there are no changes to the economic characterisation of the Singapore taxpayer over the entire tested period. For instance, one needs to evaluate whether it may be appropriate to apply term-testing if the taxpayer operates as a contract manufacturer in FY 2018 and FY 2019 and as a licensed manufacturer in FY 2020.

The use of term-testing will likely help with the reduction of TP adjustments as well as management of cash outflows for Singapore taxpayers in connection with FY 2020. Having said that, the maximum benefit of term-testing may likely be realized only by taxpayers who have, at the minimum, generated arm's length TP outcomes in the past years.

APA procedural clarifications

The clarifications issued by the IRAS are broadly consistent with the guidance issued by the IRB and the ATO. The IRAS has demonstrated its intent to be "open for discussions" and will engage with taxpayers to assess the impact of COVID-19 on their existing APAs as well as ongoing applications. In fact, for taxpayers not impacted by COVID-19, the IRAS will continue the APA process as usual.

Taxpayers are expected to evaluate the impact of COVID-19 on the critical assumptions as well as key terms and conditions of the APA and approach the IRAS for a consultative discussion. However, Singapore taxpayers still need to undertake the steps mentioned earlier i.e. undertake a strategic review of their TP arrangements and prepare robust supporting analyses and evidences to support the TP position in consultation with the GHQs and worldwide related parties. Based on the documentation prepared, taxpayers can assess the direction in which they expect the APA negotiations to flow including undertaking strategic discussions with the GHQ and related parties as to whether to pursue the existing APA or withdraw/terminate the APA. This applies to both unilateral as well as bilateral/multilateral APAs.

Taxpayers can also explore the option of including term-testing as a key condition in the APA for FY 2020 and discuss the same with the IRAS. In cases involving a Bilateral APA, taxpayers can seek support from the IRAS to discuss the option of using term-testing with the overseas tax authority and obtain tax certainty in Singapore as well as the overseas tax jurisdiction, thereby mitigating double taxation risk.

Where the APAs are terminated by mutual consent, Singapore taxpayers may be concerned of being exposed to the risk of double taxation. In such an event, taxpayers will still have the option of addressing double taxation by invoking a MAP process with the IRAS and overseas tax authority (subject to availability of MAP article in the tax treaty). However, the MAP process may not be invoked until a TP adjustment and double taxation is actually suffered by the Singapore taxpayer.

In conclusion, the guidance from IRAS addresses Singapore taxpayer's key concerns on the impact of COVID-19 at this stage. However, it does not emphasise on granular aspects such as the treatment of losses for limited risk distributors/service providers, etc. These aspects are currently being dealt by the OECD Working Party No. 6 and we understand the IRAS is participating in this process. Once the OECD Guidance is released before the end of the year, it is expected that the IRAS may update this guidance or communicate its position on the OECD Guidance to taxpayers.

Contacts

For more information on the above or any other matters, please contact either the listed contacts below, or any member of the [Singapore Tax & Legal team].

Tax Services

See Jee Chang **Avik Bose** **Jun Igarashi**

Transfer Pricing Leader
Deloitte Singapore

+65 6216 3181
jcsee@deloitte.com

Transfer Pricing Partner
Deloitte Singapore

+65 6216 3369
avbose@deloitte.com

SEA Japanese Transfer Pricing Leader
Deloitte Southeast Asia

+65 6800 2989
juigarashi@deloitte.com

Sujay Thakkar
Transfer Pricing Director
Deloitte Singapore

+65 6530 5516
suthakkar@deloitte.com

Uziel Alvarez
Transfer Pricing Director
Deloitte Singapore

+65 6800 2508
uzalvarez@deloitte.com

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