



Singapore Transfer Pricing developments Committed to your success

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 update you on the following:

Transfer Pricing guidelines on centralised activities in multinational enterprise groups

On 19 March 2021, the Inland Revenue Authority of Singapore (IRAS) released its transfer pricing guidelines for multinational enterprise (MNE) Groups with centralised activities. This is through a new e-tax guide titled “Transfer Pricing Guidelines: Special Topic—Centralised Activities in Multinational Enterprise Groups”, which supplements the Singapore Transfer Pricing Guidelines (Fifth Edition) (Singapore Transfer Pricing Guidelines) issued on 23 February 2018.

This new e-tax guide can be split into two parts. The first part discusses the economic value contributions of centralised activities in Singapore and their importance to a MNE group. The second part provides guidance on how to analyse such activities carried out in Singapore between related parties, the factors that may affect the pricing for these activities, and the appropriate transfer pricing methods.

Key Highlights

The e-tax guide highlights Singapore’s well-established role as home to a large number of MNE headquarters who may be looking to centralise key decision-making, management and coordination, build customer insights and develop product and services strategies for regional markets. The e-tax guide stresses that there are many possible different transactions in the context of MNE groups and thus thorough examination of the actual functions performed,

assets used, and risks assumed in each specific related party transaction is important in determining the arm's length transfer price.

Benefits of centralised services in Singapore

The first section of the e-tax guide is developed with the support of the Singapore Economic Development Board (EDB) and sets out a summary of the commercial benefits for MNE groups in centralising certain activities at a headquarter¹ based in Singapore. The list of benefits for centralising services include: directing overall business performance and aggregating specialised knowledge; accelerating decision making in response to market conditions; achieving economies of scale and cost efficiencies; driving consistency in branding, marketing and creative strategies and capturing real-time market opportunities; and proximity to markets.

The e-tax guide acknowledges that MNEs may set up headquarters in different locations based on a variety of considerations. It highlights that Singapore is often one of the preferred location for setting up the headquarters due to the presence of the following key attributes: business capital of Asia; sophisticated ecosystem with supply chain management capabilities; global financial centre; strong talent base; political stability; established infrastructure, both in terms of legal, regulatory and tax framework, and digital infrastructure and cyber resilience.

Pricing of activities centralised in Singapore

The second section of the e-tax guide focuses on how related party transactions are analysed and the transfer pricing methods that could be used to price these centralised activities. Given the variety of services that an MNE groups could centralise, it is vital for the transfer pricing analysis to delineate the actual related party transaction, in the context of the MNE group's business and nature of the transaction itself.

Consistent with the Singapore Transfer Pricing Guidelines, the functional profile of the headquarter is dependent on the nature of its activities and the risks assumed. Where the headquarter assumes a risk for transfer pricing purposes, it needs to both control the risk and have the financial capacity to assume the risk. Therefore, it is important to understand how value is generated by the MNE group as a whole and the interdependencies of the functions performed by the headquarter with the rest of the group and the contribution of the headquarter to value creation. The value drivers of any individual MNE group will vary from business to business. Contribution to value creation is not based on the number of functions performed, but the economic significance of those functions, considering the frequency, nature and value to the respective parties.

The e-tax guide categorises the role of the headquarter in centralised related party transactions into four broad categories:

1. Principal in distribution, manufacturing or research and development arrangements, where it carries out risk taking and decision making related to these arrangements;
2. Activities relating to core business processes, providing services that tend to correlate to revenues of the profit of the MNE group (e.g., procurement, sales, highly technical backend operations for regulatory compliance, etc.);
3. Activities relating to administrative, technical, financial, commercial, management, coordination and control functions, which are not part of the supply chain of goods/services but support the smooth operation of the MNE group; and
4. Shareholder activities, those which do not benefit the group entities and so for which a service fee cannot be charged.

Related party transactions can be conducted at different levels of intensity and scope. Some examples of services in each of the four categories is provided in the e-tax guide. The e-tax guide then provides examples of the assets that may be utilised by the headquarter, depending on its role within the value chain.

Due to the myriad range of activities that could be centralised, there are many different risks that the headquarter may encounter. Where the headquarter assumes a risk, it needs to control the risk and have the financial capacity to bear it. The e-tax guide provides a non-exhaustive table of typical risks encountered by headquarters when they act as principal or are performing activities relating to the core business processes. Where the headquarter acts as principal it would typically assume all/some of the key business risks and have the decision making capability to take on, lay off or decline a risk-bearing opportunity. In comparison, where the headquarter conducts activities relating to core business processes, the headquarter would usually manage the critical business risk for the MNE group. Example of the different roles of the headquarter using global supply policies and procedures, and Intellectual Property (IP) ownership is provided in the e-tax guide.

The general approach to analysing the headquarter activities is no different from the approach for analysing other intragroup transactions, and effort should be made to price the actual related party transaction for headquarters as accurately delineated using the five accepted methods set out in the Singapore Transfer Pricing Guidelines, any other appropriate method, or a combination of methods. When selecting the appropriate method, it is important to also consider common industry practices as well as availability of reliable independent comparables.

Where the headquarter acts as a principal, these transaction are in practice tested using one sided methods, with the related party being the tested party as the headquarter would usually have the more complex functional profile. For contract manufacturers and research and development service providers these would usually be tested using the cost-plus or the transactional net margin method (TNMM) using costs as an appropriate base. For distributors responsible for driving sales in their markets, they would usually be tested using resale price method or TNMM using sales as the appropriate base. Where distributors do not drive sales, the distributors may be rewarded using the cost-plus method or TNMM using cost as an appropriate base (including Berry Ratio which could be applied provided the conditions for application of Berry Ratio as provided in the Singapore Transfer Pricing Guidelines are met).

Where the headquarter conducts activities relating to core business processes or provide administrative centralised services, these transactions are tested depending on the nature of the activities. If the service provider shares in the risks and rewards, a profit split between the service provider and the other related parties may be appropriate. This would be possible where the services relate to core business processes and is typically part of the supply chain of the MNE group. In other instances, a TNMM approach may be appropriate where the value of the services provided is driven by its costs. The mark-up would be determined based on a comparability analysis of service providers of similar profile, or where applicable, the practices accepted by IRAS for routine support services provided under Annex C of the Singapore Transfer Pricing Guidelines.

Where the headquarter assumes economically significant risks and is characterised as the entrepreneur, it should receive the residual profit. In contrast, where the headquarter does not assume economically significant risks, does not make key business decisions and is characterised as a service provider it would only receive a fixed return. This would also be applicable to MNE groups that adopt decentralised business models (e.g., with full risk distributors). A case study setting out the different types of services being

provided by the headquarter and their respective analysis is provided in Annex A of the e-tax guide.

Transfer Pricing documentation

The e-tax guides reconfirms the need to prepare transfer pricing documentation if the conditions set out in the Singapore Transfer Pricing Guidelines are met. Failure to comply with the documentation requirements could result in a fine as stipulated under the Singapore Transfer Pricing Guidelines.

The e-tax guide also set out the information IRAS expects to be included in the transfer pricing documentation. These requirements are consistent with those already set out in the Section Six of the Singapore Transfer Pricing Guidelines, with additional emphasis on providing details of the value chain of the MNE group as a whole and the interdependencies and contributions of the headquarter and its related party functions. IRAS also states that reliable evidence (such as examples of risk materialisation) and document to support the headquarter's assumptions and management of risks should also be provided in the transfer pricing documentation.

Avoiding and resolving transfer pricing disputes

The e-tax guide reminds taxpayers that transfer pricing disputes can be avoided and certainty of tax treatment for future years can be obtained in advance through advance pricing arrangements (APA).

Where taxpayers suffer double taxation from adjustments made by the IRAS or a foreign tax authority on the transfer prices of its related party transactions, they can choose to resolve the issue through taking legal remedies in the jurisdiction in which the transfer pricing adjustments are made and/or requesting the IRAS to resolve the double taxation through the Mutual Agreement Procedure (MAP).

¹ The term headquarter has been used to broadly refer to the group entity providing the centralised service. It does not mean that the entity should be the MNE Group's global headquarters. It could be a regional headquarter or may be only involved in providing centralised services globally or regionally. Therefore headquarters may have functional profile ranging from a service provider to an entrepreneur.

Deloitte Singapore's view

This e-tax guide is the second "special topic" to supplement the Singapore Transfer Pricing Guidelines. Unlike the first special topic e-tax guide, which focused on the transfer pricing of commodity marketing and trading activities, this e-tax guide provides a less industry-focused and more general guidance. Whilst the e-tax guide specifically refers to those activities that may be centralised in MNE groups, it nonetheless set out principles that would also be applicable to other types of related party services.

The e-tax guide recognises that MNE groups may choose to centralise a wide variety of different services through different business models and with variations in intensity of activities undertaken, assets used and risks assumed by the headquarter. As such, the e-tax guide sets out broad principles along with examples of different functional profile of centralised related party service providers.

The principles set out in the current e-tax guide is consistent with the guidance on the arm's length principle and conducting of a comparability analysis set out in Section Five of the Singapore Transfer Pricing Guidelines, but applies this specifically to the context of related party services centralised in Singapore. The issuance of the guidance by IRAS reflects the importance of ensuring that

appropriate analysis is in place to support the arm's length pricing of related party service providers.

The e-tax guide reinforces a "substance" based approach to transfer pricing, which examines the "economic value" of the actual activities in the context of the overall MNE group value chain as well as the significance, experience and decision making capabilities of key individuals employed by the headquarters. This signals the IRAS' willingness to consider the bigger picture and the overarching principle that total remuneration for the centralised service providers should always commensurate with its functions, assets, and risks profile.

The release of the guidance, setting out the transfer pricing approach adopted by IRAS toward related party services providers presents a good opportunity for MNE groups with Singapore inbound and outbound related party services to review their existing transfer pricing policies and ensure that robust analysis of the services transactions in the wider context of the MNE group value chain are appropriately documented.

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