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Global Tax Alert

News from Transfer Pricing

Singapore provides transfer pricing guidance related to impact of COVID-19

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The Inland Revenue Authority of Singapore (IRAS) released *COVID-19 Support Measures and Tax Guidance*[1] for transfer pricing (TP) on 7 September 2020.

The ongoing COVID-19 pandemic has caused significant disruption to people movements, supply chains and business operations, with devastating financial impact for many companies. Consequently, many businesses have sought clarity on various tax aspects related to the impact of COVID-19 on their operations, and the IRAS has periodically released guidance to give taxpayers more certainty regarding tax considerations arising from COVID-19, such as Singapore tax residency and permanent establishment issues related to COVID-19 and the tax treatment of various COVID-19-related government support payments.

In the latest release, the IRAS has responded to certain TP questions commonly asked by taxpayers who are dealing with the daily disruption caused by COVID-19, addressing the following issues:

- TP documentation: The IRAS has set out the information to be provided in the TP documentation to substantiate the arm's-length nature of a taxpayer's TP outcomes arising from COVID-19.
- Term testing: The IRAS has indicated willingness for a taxpayer to apply term testing (i.e., test of the related party transaction over a multiple-year period) for the Year of Assessment (YA) 2021 due to the COVID-19 impact without prior consultation with the IRAS under certain circumstances.
- Advance Pricing Arrangement (APA): The IRAS has indicated that taxpayers should assess how COVID-19 is expected to impact the APA discussions and encourages taxpayers to have open discussions with the IRAS to resolve issues (if any).

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Implications

To assess the tax implications of COVID-19, it is critical to understand the business outlook and financial impact of COVID-19. It is also essential to identify whether and how COVID-19 has caused changes in trade flows, location of decision-making, as well as where functions are performed, assets are owned, and risks are assumed within the group.

In light of the IRAS' COVID-19 guidance, a corporate group will need to evaluate, in the short to medium term, how it will support the financial results of its group entities taking into account the impact of COVID-19 on its business. The IRAS has set forth the additional supporting analysis that it expects, including an analysis of COVID-19 commercial impacts, changes in contractual terms, fact pattern around whether functions, assets and risks were reallocated as well as financial information. From a TP technical viewpoint, reflecting these economic conditions using third-party information is also recommended.

A detailed analysis will assist with IRAS' queries or review and will support any exceptional financial outcomes arising from COVID-19. This analysis is likely to entail:

- TP documentation: TP compliance documentation spanning the COVID-19 period, which incorporates the commercial impact of COVID-19 and how this impacts business operations. Benchmarking studies should be updated, where possible and relevant.
- Updated intercompany agreements: Where changes in terms arose, these should be updated and aligned with the TP policy or TP documentation.
- TP defense memorandum: Supplementary documents to the TP documentation that may include further details on the COVID-19 impact to the business, market conditions, details on the operational changes arising from COVID-19 such as changes in trade flows, reallocation of functions, assets and risks, and other supporting financial information.

In tandem, TP adjustments may be needed as a result of such TP analysis. Where such adjustments are required, consideration should also be given to the analysis and types of information required by the IRAS as set out in its latest guidance to substantiate the level of adjustments to be made and by whom. Corporate groups will also need access to up-to-date financial information in order to make such an assessment.

In the medium- to long-term, corporate groups may have to consider whether business operations, e.g., trade flows, changes in decision-making locations and processes, new business ventures or new ways of doing business, warrant a refresh of their operating and TP model.

With tax authorities sharpening their focus on the TP practices of corporate groups to protect and secure their tax base, it is important that corporate groups make even more concerted efforts to show they have robust processes and controls in place to align TP outcomes with TP policies.

Similar to tax authorities elsewhere, the IRAS is also increasingly looking at whether the year-end results of Singapore taxpayers, including any year-end adjustments made, are appropriate and consistent with arm's-length outcomes. Further, from the Year of Assessment 2019, the IRAS can apply a surcharge of 5% on the amount of TP adjustments it makes on a taxpayer. TP enforcement in Singapore is therefore expected to be further increased going forward.

Faced with an aggressive tax and TP environment globally, it is increasingly necessary for corporate groups to invest more time and effort in designing operational TP-related processes and systems to ensure that intercompany pricing is effective and the related accounting aspects meet regulatory and business objectives. An effective operational TP program will help align TP requirements with business goals, better ensure TP compliance and mitigate TP risks for corporate groups.

Endnotes

1. IRAS' weblink: https://www.iras.gov.sg/irashome/COVID-19-Support-Measures-and-Tax-Guidance/Tax-Guidance/Transfer-Pricing/.

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