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Global Tax Alert

News from Transfer Pricing

Singapore's Inland Revenue Authority releases transfer pricing guidelines for commodity marketing and trading activities

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Executive summary

On 24 May 2019, the Inland Revenue Authority of Singapore (the IRAS) released the transfer pricing (TP) guidelines for commodity marketing and trading activities (e-Tax Guide), which provide guidance on how to analyze the economic value of commodity marketing and trading activities (commodity marketing/trading activities) in Singapore. The e-Tax Guide outlines the various factors that may affect the transfer pricing for these activities, discusses appropriate TP methods that may be applied and highlights the benefits and common roles of conducting commodity marketing/trading activities in Singapore.

Commodity marketing/trading entities are often part of a complex value chain, performing a wide range of activities that require varying levels of effort, and contribute in various ways to a commodity multinational enterprise's (commodity MNE) overall value chain. The 2018 Singapore TP Guidelines (Fifth Edition) (2018 Singapore TP Guidelines) should be read and applied together with the principles set forth in the e-Tax Guide.

Detailed discussion

Commercial objectives and functional profile for commodity marketing/trading entities

The IRAS introduces four broad levels of participation that commodity marketing/trading entities may undertake. These include a service provider, agent, distributor and full risk-taking entrepreneur. The e-Tax Guide examines the various levels of activities, stipulating the key functions that each level of participation should assume.

Further, the e-Tax Guide discusses the specialized assets required to optimize production, plan resources, reduce storage requirements and maximize profits throughout the commodity value chain, including how these assets should be compensated.

The e-Tax Guide also highlights the risks stemming from commodity marketing/trading activities and includes examples of possible ways to control or mitigate these risks.

Applicable transfer pricing methods

The e-Tax Guide discusses each transfer pricing method in relation to the four broad commodity marketing/trading participation levels and provides specific examples of when a certain method should be applied. For example:

- ▶ Commission rates for activities involving an agent or marketing activities
- ▶ London Metal Exchange (LME) for pricing commodities based on a percentage of the LME price
- ▶ Means of Platts Singapore for pricing jet fuel, gasoline and diesel
- ▶ Combination of indices for pricing liquefied natural gas (i.e., hybrid of crude oil index and Henry Hub gas price)

Additionally, practical solutions are offered for entities encountering difficulties in applying certain methods.

Additional transfer pricing documentation requirements

The 2018 Singapore TP Guidelines outline the TP documentation requirements for Singapore taxpayers. The e-Tax Guide adds to the existing requirements by listing specific information that commodity marketing/trading entities must include in their TP documentation.

Implications

Taxpayers with commodity marketing/trading activities in Singapore should assess their contribution to the commodity MNE broader value chain. A thorough analysis of the functions performed, assets used and risks assumed in each related-party commodity transaction should be evaluated. Taxpayers should review and consider the appropriateness of the TP methodology they use in light of the IRAS' proposed methods in the e-Tax Guide.

For Singapore taxpayers with related-party commodity transactions, the e-Tax Guide will enable them to analyze their operations to ensure they have the required substance and support for their commodity marketing/trading activities. This is particularly relevant for entities with related party transactions with Australia, given the Australian Taxation Office (the ATO) Practical Compliance Guide (PCG) that sets out the ATO compliance approach to TP issues related to centralized operating models (hubs) involving procurement, marketing, sales and distribution functions. The PCG resulted from ATO's concern about a perceived underreporting of income by offshore entities operating as hubs in supply chains, particularly foreign hubs used by Australian businesses in marketing exports from Australia.

A key difference between Singapore's e-Tax Guide is the PCG's emphasis on the maintenance of appropriate evidence to justify the economic substance and purpose of the marketing hub, particularly when the taxpayer falls outside the safe risk rating "green zone". This includes evidence on the decision-making capacity, why risks are borne, how risks are managed and how this produces a valuable economic contribution to profits. Further, evidence is requested to support the profit accruing to the hub and why this is reflective of the economic contribution provided by the hub.

In comparison, the e-Tax Guide provides a detailed explanation and highlights the key value being created by strategically-placed marketing hubs and identifies a myriad of support and potential evidence for the functions being performed by commodity hubs in Singapore. For example, the e-Tax Guide identifies as a key value, the benefit that Singapore as a country provides (location specific advantages) to a transaction, and analyzes in detail the various structures seen and value attributed to these structures based on the respective functions performed, risks assumed and assets borne by hubs in Singapore. As such, the e-Tax Guide is helpful in assessing an entity's operations and determining whether they undertake the required functions to support the profitability levels earned in Singapore.

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