



KEY TAKEAWAYS

- Publicly available information may be retrieved and used to test certain related party transactions, while subscription to commercial databases may be required to get access to certain financial data for other related party transactions.
- To adhere to the arm's length principle, it is essential for the company to have a thorough understanding of the conditions and circumstances surrounding the transaction.
- Businesses should be proactive in planning their TP strategies and processes, and working them into the company's natural business lifecycle.

Indicative margins are generally applicable for loans under a certain value. What can be done if a related party loan exceeds the threshold? This was just one of the many transfer pricing (TP) issues discussed at a new-format online session organised by the [Singapore Chartered Tax Professionals](#).

During the robust session which focused on TP queries raised by participants, Adriana Calderon, Director, Transfer Pricing Solutions Asia, provided practical insights into the current TP climate as well as the variety of TP issues raised by the participants. Here are some of the highlights.

1) Could you share, based on your experience, some of the tools and resources used for benchmarking analysis?

A benchmarking analysis (or comparability analysis) is conducted to compare the related party transaction being tested, with transactions entered into between independent parties in same or similar circumstances. It is performed using internal comparables (which compare the related party transaction being tested with similar transactions carried out by the company and independent parties) or external comparables (which compare the related party transaction being tested with similar transactions carried out between independent parties).

Internal comparables, where available, can usually be easily retrieved from the company's financial system or records. However, there may be scenarios where internal comparables are not available (for example, where a company manufactures and sells its products exclusively to related parties).

In the absence of suitable internal comparables, the company would have to rely on external comparables.

Publicly available information (such as financial statements, central bank interest rates, or commodity indices) may be retrieved and used to test certain related party transactions. For other related party transactions, taxpayers may need to subscribe to commercial databases to get access to the financial data.

When using commercial databases, the key is to select suitable and reliable external comparables by sensibly screening the data based on industry classification, business description, geographical locations, scale of operations, as well as other appropriate factors for the specific type of transaction.

2) How do we ensure that an organisation's transfer prices are established in accordance with the arm's length principle?

The arm's length principle requires a transaction with a related party to be made under comparable conditions and circumstances as a transaction with an independent party. This is premised on the fact that where market forces drive the terms and conditions agreed in an independent party transaction, the pricing of the transaction would reflect the true economic value of the contributions made by each party in that transaction. In practice, it is noted that tax authorities are increasingly focusing on the "big picture" to understand the specific role of the taxpayer and the nature of the transaction in the overall scheme of things.

To adhere to the arm's length principle, it is essential for the company to have a thorough understanding of the conditions and circumstances surrounding the transaction, including the group's business model, the related parties involved, their respective roles in the overall supply chain, as well as the specific nature of the transaction. If the company does not have a clear understanding of its role and of the related party transaction, it will not be able to arrive at a good basis to determine the appropriate market data or comparables to use for its benchmarking analysis.

3) What should taxpayers do when the indicative margin (or safe harbour) for related party loans is different in the two relevant countries?

To alleviate the compliance burden and uncertainty faced by taxpayers, some tax authorities provide an indicative margin for related party loans. Taxpayers may choose to approximate an arm's length interest rate for their loan by adding the indicative margin to their choice of base reference rate. However, such safe harbours are typically unilateral and do not provide certainty in the other jurisdiction.

In an independent loan transaction involving a bank and a borrower, the focus will generally be on the credit ratings of the borrower and its risk of default. Similarly, where there is conflict between the indicative margins on related party loans between two countries, the company may first consider the transaction from the borrower's perspective, and accordingly, rely on the indicative margin of the borrower's jurisdiction. In practice, this approach may not always sit well with the tax authority of the lender's jurisdiction as it may be opined that the transfer price is inadequate. Tax disputes may ensue.

Indicative margins are generally applicable for loans under a certain value. In Singapore, taxpayers can only choose to apply the indicative margin to a related party loan if it does not exceed \$15 million at the time the loan is obtained or provided. Where indicative margins are not applicable, the company may need to perform a TP analysis on the loan transaction and apply an arm's length interest rate based on the analysis.

Where the size of the loan is substantial or if certainty is important, the company may consider applying for a bilateral Advance Pricing Arrangement (APA), which is essentially an agreement between IRAS and an Avoidance of Double Taxation Agreement (DTA) partner on the transfer price of a transaction between entities in their respective jurisdictions. As the application of bilateral APA is a resource-intensive exercise, taxpayers should consider it only for substantial or important transactions.

4) From your experience, what are some common misconceptions that taxpayers may have in regard to TP documentation?

One common misconception that taxpayers have is that as long as a company manages to put together a lengthy TP documentation just before the tax-filing due date (such that it qualifies as contemporaneous TP documentation), its TP issues will all be resolved.

To successfully manage TP, the company needs to plan for the right people, processes, and technology to be put in place and ensure that the right data are captured for TP purposes. It is essential for taxpayers to recognise that the TP planning should start before a transaction is carried out. In practice, the TP lifecycle generally starts with the careful planning of TP strategies and, subsequently, the execution of the TP policies when the transaction is carried out.

TP documentation captures the relevant information of the group's businesses that are relevant to the business operations in Singapore, as well as the details of the Singapore taxpayer's business and transactions with its related parties.

However, no matter how lengthy or well written the TP documentation may be, it cannot change the substance of the company's TP policies, processes, or transactions. If a company has carried out its related party transactions haphazardly and only prepared its TP documentation before the tax-filing due date, it may be too late for the company to amend its TP positions to comply with the arm's length principle.

As the TP landscape changes, passively reacting to TP issues only when the tax authority raises a query or launches a TP audit is no longer enough. Instead, businesses should be proactive in planning their TP strategies and processes, and working them into the company's natural business lifecycle.

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