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→ New Singapore Transfer Pricing Guidelines

Singapore issued new TP Guidelines on centralized activities in multinational enterprise groups

On 19 March 2021, the Inland Revenue Authority of Singapore (“IRAS”) has issued its transfer pricing guidelines for multinational enterprise (“MNE”) groups with centralized activities (“the Guide”).

The aim of this Guide is to discuss the economic value contributions of centralized activities in Singapore, and their importance to an MNE; and to provide guidance on how to analyze such activities carried out between related parties, a factors that may affect the transfer price for these activities and the appropriate transfer pricing methods.

The Guide acknowledges that companies choose to centralize certain activities in a certain location due to a variety of considerations. This includes the ability to direct overall business performance, to aggregate specialized knowledge, to accelerate decision making, to achieve economies of scale and cost efficiencies, to drive consistency in branding, marketing and creative strategies, to capture real-time market opportunities, and to establish proximity to markets. Singapore is often considered a preferred location for setting up headquarters due to the city state being regarded as the business capital of Asia, having sophisticated supply chain management capabilities, a strong talent base and a robust legal, regulatory and tax framework.

Analysis and Pricing of Headquarters Functions

With this, the Guide provides guidance on the approach to analyze and apply an appropriate transfer pricing method to these centralized activities. Given the diversity of services an MNE group may centralize, it is important to accurately delineate the actual related party transaction such that it can be understood in the context of the business of an MNE group, as well as the nature of the transaction itself.

In addition, it is important to determine the functional profile, as the functional profile of a headquarters is dependent on the nature of activities it conducts (taking into account assets used and risks assumed) which in turn define its contribution to value. 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 headquarters with the rest of the group, as well as the contribution of the headquarter to value creation. Contribution to value is not determined by the number of functions performed, but by the economic significance of those functions.

The Guide broadly describes the role of headquarters in centralized functions as follows:

- **Principal in distribution, manufacturing, or research and development arrangements:** Where the headquarters acts as a principal, it carries out risk taking and decision making in these arrangements.
- **Activities relating to core business processes:** Where the headquarters provides services to other group entities that relate to the core business processes of the group, typically forming part of the supply chain of goods and/or services within the group, to help improve the overall performance of the group. It extends beyond administrative and executory services.
- **Activities relating to administrative, technical, financial, commercial, management, coordination and control functions:** These services are usually not part of the supply chain of goods and/or services, but support the smooth operation of the MNE group. The services performed tend to be routine and standardized, thus improving efficiencies.
- **Shareholder activities:** These services do not benefit the group entities, and as such the headquarters cannot charge a service fee in respect of these activities.

The Guide also provides examples of the assets that may be utilized by a headquarters and typical risks that may be assumed by a headquarters, depending on the functional analysis.

The general approach to analyzing intra-group headquarters activities is no different from the approach in analyzing other intra-group transactions. If the activities performed are

benefiting the MNE Group, the headquarters should be compensated on an arm's length basis.

In the absence of compensation made to the headquarters, a compensation may be deemed to have been received by the headquarters. The amount of deemed compensation should be determined based on appropriate analysis and should be subject to tax in Singapore.

Below we will set out a summary of the suggested transfer pricing methodology ("TPM") set out in the Guide based on the following arrangements.

Arrangement	TPM
Principal in distribution, manufacturing or research and development	<ul style="list-style-type: none"> - Comparable Uncontrolled Price ("CUP") Method if comparable transaction can be found. (In practice it is quite difficult to apply); - Cost Plus Method ("CPM") or Transactional Net Margin Method ("TNMM") for contract manufacturers and research and development service providers using costs as the appropriate base; - TNMM for distributors responsible for driving sales within the market they operate in using sales as the appropriate base. Where distributors do not drive sales, a CPM or TNMM using the berry ratio may be used.
Activities relating to core business processes or administrative centralized services	<ul style="list-style-type: none"> - CUP Method where there is a comparable service provided to third parties or comparable service provided between independent parties (in practice it is quite difficult to apply); - Profit Split Method ("PSM") where the service provider shares in the risks and rewards of their functions; - CPM or TNMM where the value of the services provided is driven by its inputs into the process, i.e. costs.

Documentation requirements

The transfer pricing documentation requirements remain the same. The requirements set out in this Guide are consistent with the Singapore Transfer Pricing Guidelines with added emphasis on providing details of the value chain of the MNE group as a whole, the inter-dependencies of the functions, and the contribution that the headquarters makes to the value creation. Reliable evidence to support the headquarters assumption and management of risk should be included in the transfer pricing documentation.

Our view

The issuance of this Guide reinforces the substance over form approach adopted by the Singapore tax authorities, which examines the economic value of the functions, risks and assets of a headquarters in the context of the overall MNE group. This Guide should help MNE groups with headquarters in Singapore with their group structures.

Companies should take this opportunity to review their existing structures and transfer pricing models and ensure that they are robust; and, where necessary, consider if any changes need to be made.

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