

# Upcoming Changes to Lease Accounting

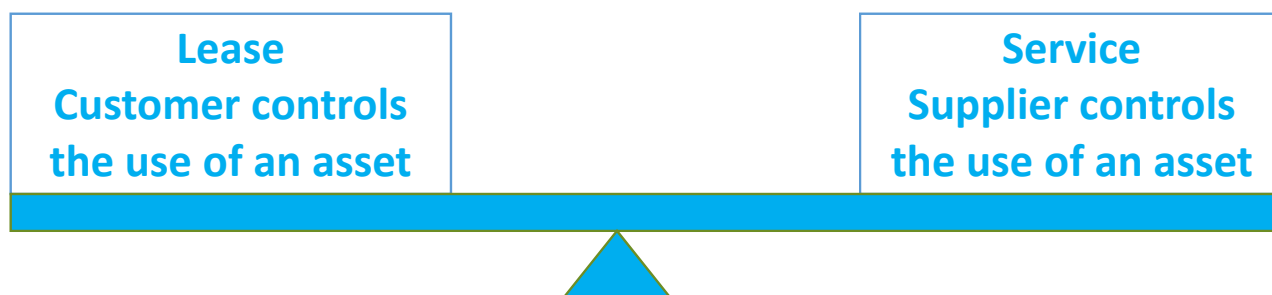
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31 March 2016

## For lessees, it's a finance lease..



- Globally, changes expected to be issued within next 3 months and become effective 1 January 2019.
- In Singapore, not yet issued by ASC.
- Lessees will capitalise all leases, except leases < 12 months and “small” assets.
  - recognise lease assets/liabilities on the balance sheet at present value of unavoidable lease payments
  - amortise lease assets and record interest on liabilities
- Revised definition of lease vs. service



- **Lessor accounting remains substantially similar to IAS 17**

# What is a lease?



- A lease exists when:
  - Lessee has right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use; and
  - Lessee directs the use of the identified asset throughout that period.
- Detailed implementation guidance will be provided

## Illustration 1



Charterer enters into a voyage charter contract with a ship owner (Supplier) for the transportation of cargo from Rotterdam to Sydney on a specified ship.

- Ship is explicitly specified in the contract
- Charterer was not involved in acquisition or design of ship by Supplier
- Supplier does not have rights to substitute the ship with another
- Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship
- Charterer is prohibited from hiring another operator for the ship during the term of the contract
- Charterer is prohibited from operating the ship
- Cargo will occupy substantially all of the capacity of the ship
- **Contract specifies the cargo to be transported on the ship and the dates of pickup and delivery**

Conclusion: Does not contain a lease

## Illustration 2



Charterer enters into time charter contract with a ship owner (Supplier) for the use of a specified ship for a five-year period.

- Ship is explicitly specified in the contract
- Supplier does not have rights to substitute the ship with another
- Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship
- Charterer is prohibited from hiring another operator for the ship during the term of the contract
- Charterer is prohibited from operating the ship
- **During charter period, charterer decides whether and what cargo will be transported; when and to which ports the ship will sail**
- **Charterer is contractually restricted from sailing the ship into waters with high risk of piracy or carrying dangerous goods.**

Conclusion: Contains a lease

Consider all facts and circumstances

# Considerations for Finance Teams



- Review of lease/ charter agreements
- New accounting judgments
- New systems and processes
- Changes in financial metrics
- Changes to terms of business
- Stakeholder communication
- Future changes?



**Taxation!**

# Updates on Recent Developments with Particular Emphasis on Transfer Pricing

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# What is Transfer Pricing ?



Transfer pricing refers to the pricing of the transactions between related parties

When two related entities enter into any related parties transactions, the price at which they undertake the transaction is 'transfer price'

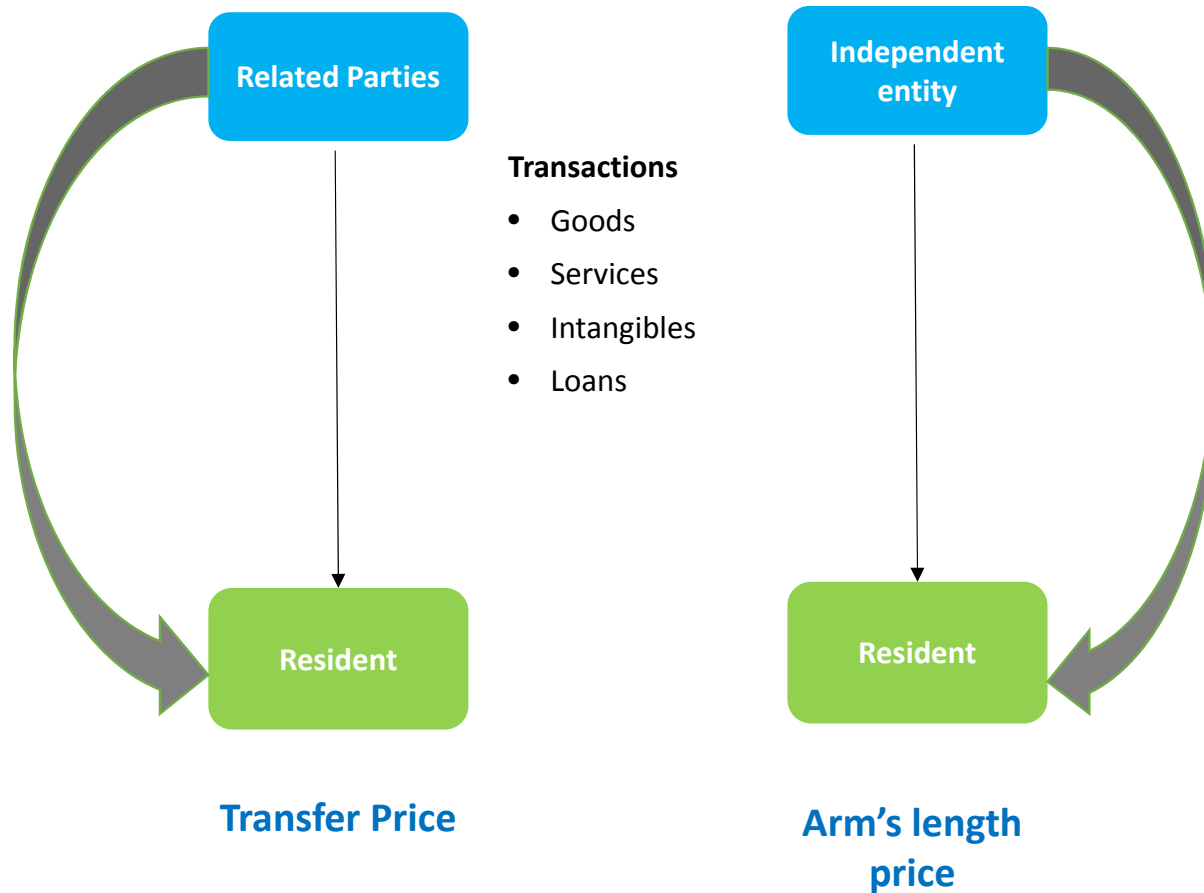


Due to special relationship between the related companies, the transfer pricing may be different than the price that would have been agreed between unrelated companies

Price between unrelated parties in uncontrolled conditions is known as the "arm's length" price (ALP)



# What is Transfer Pricing ?



## Transfer pricing for tax purposes is

- Governed by local jurisdictional authorities.
- Many countries have issued formal rules regulating transfer pricing practices.
- Regulations, prescribe stringent documentation requirements and penalty provisions for non-compliance

# Why Transfer Pricing ?



- To ensure fair share of tax revenue for various jurisdictions



To prevent shifting out of profits by  
manipulating prices

# The OECD BEPS initiative



- The Organisation for Economic Co-operation and Development (OECD) transfer pricing guidelines, is widely acknowledged by tax authorities around the globe to determine transfer pricing.
- What is Base Erosion and Profit Shifting (BEPS)?
- Transfer pricing is central to the OECD's initiative to combat BEPS

Transfer pricing now presents not just a financial risk but also a reputational risk, with many multinational companies coming under the spotlight of tax administrations

## The OECD BEPS initiative (cont..)



- Singapore government is on record that it supports the BEPS project and it is clear that BEPS-related considerations are high on its agenda

The screenshot shows the website of the Singapore Ministry of Finance. At the top left is the MOF logo. To the right are links for 'Email Subscription | Contact' and a search bar. A red navigation bar contains links for 'Home', 'MOF For...', 'About Us', 'Policies', 'Resources', 'Newsroom', 'Singapore Budget', and 'Public'. Below the navigation bar, the breadcrumb trail reads 'Home / Newsroom / News'. The main heading is 'Singapore Welcomes the OECD's Recommendations to Counter Base Erosion and Profit Shifting ("BEPS")'. The first paragraph of the article begins with '1. Singapore welcomes the Organisation for Economic Co-operation and Development's (OECD) final BEPS recommendations to the G20 for an international approach to combat tax avoidance. We believe that sound implementation of the BEPS principles, with all tax jurisdictions being included in the process, will help foster free and fair economic competition.'

# The OECD and the Singapore transfer pricing (TP) guidelines



- The 2006 Singapore TP guidelines already advocated an approach based on group and entity-level information, which is similar to the latest guidance from the OECD
- Singapore has had transfer pricing guidelines in place since 2006; new, comprehensive guidelines were released by the IRAS in January 2015 and again in January 2016
- Since the 2015 Singapore TP guidelines have further advocated this approach, they are broadly aligned with the proposals put forth in the OECD – BEPS Action # 13 report – Transfer Pricing Documentation
- A subtle difference may be Singapore’s requirement for group level and entity level information versus the OECD requirement for a separate global file

## Question



**Do you maintain or prepare Singapore transfer pricing documentation?**

A. Yes. Updated annually or have an APA covering all transactions

B. Yes. But it is out of date and we do not update it annually

C. No. We rely on a regional or global document

D. No. We deal with IRAS questions when they arise

**What is transfer pricing documentation?!**

# What is Transfer Pricing Documentation?



- Transfer pricing documentation – records kept by taxpayers to show that efforts have been made to ensure that their related party transactions are concluded at arm's length

| Group information  | Singapore entity information   | Transaction information   | Transfer Pricing Analysis                                     |
|--|--|---|---|
| Worldwide organisational structure with ownership linkages   | General information of Singapore taxpayer  | Detailed information of all transactions with related parties   | Choice of transfer pricing method                             |
| Group's business activities, principal activities of each party  | Entities business models and strategies (past, present and future)   | Contracts/agreements to substantiate the terms of transactions  | Choice of tested party with reasons substantiating the choice |
| Products and services, markets and competitors   | Entity's functions, risks and assets employed  | Segmental financial information for each of the transactions along with the basis of derivation of segmental accounts | Details on comparable companies                               |
| Industry profile in which the company operates   | Financial statements   |   | Comparability analysis  |
| Important drivers of profit, including a list of intangibles and the related parties that legally own them | Description of the management structure of the Singapore taxpayer, including a description of the related parties to whom the Singapore management reports |   | Details of adjustments made, if any                           |
| Business information / relationships amongst all related parties   | Organisational chart showing number of employees   |   | Determination of arm's length price / margin                  |
|  |  |   | Use of range, if required                                     |
|  |  |   | Testing the transaction against arm's length outcomes         |

# Transfer pricing in Singapore



- The most striking change is the explicit requirement for Singapore taxpayers to prepare contemporaneous transfer pricing documentation to support the pricing of transactions with related parties
- If transfer pricing documentation is not prepared then this may attract transfer pricing adjustments and penalties under the law
- In addition, IRAS may not be as supportive of the transfer pricing positions of the taxpayer when it comes to voluntary adjustments or negotiations with other tax authorities to eliminate or mitigate double taxation (Mutual Agreement Procedure and Advanced Pricing Agreements)



# Instances where transfer pricing documentation is not required



- Taxpayers are not expected to prepare TP documentation under the following situations:

- 1** Transactions between local related party and income from transactions taxed at same rate
- 2** Loan transactions between local related parties, if lender is not in the business of borrowing and lending
- 3** Provision of prescribed routine services covered by the safe harbour cost +5%
- 4** Related party transactions covered by an agreement under APA
- 5** Value of other types of related party transactions does not exceed specified thresholds (see table below)

# Instances where transfer pricing documentation is not required



| Category of related party transactions   | Threshold (S\$) per financial year |
|--|------------------------------------|
| Purchase of goods from all related parties   | 15m                                |
| Sale of goods from all related parties   | 15m                                |
| Loans owed to all related parties  | 15m                                |
| Loans owed by all related parties  | 15m                                |
| <p>All other categories of related party transactions. Examples:</p> <ul style="list-style-type: none"> <li>• Service income</li> <li>• Service payment</li> <li>• Royalty income</li> <li>• Royalty expense</li> <li>• Rental income</li> <li>• Rental expense</li> </ul> <p>For the purpose of determining if the threshold is met, aggregation should be done for each category of related party transactions. For example, all service income received from related parties is to be aggregated.</p> | 1m per category of transactions    |

# If you fall within the exclusions situations...



| Situations  | Comments   |
|---|--|
| Do you have to prepare contemporaneous TP documentation?  | IRAS says it has no expectation of you to do this.<br>Company can do so on voluntary basis, if they expect increasing level of particular type of complex related party transactions and would like to defend its pricing. |
| Will IRAS insist on submission of contemporaneous TP documentation when it reviews related party transactions, or conducts TP consultation or audit on you? | Taxpayer still need to prove to IRAS using other records that transactions with related parties reflect arm's length conditions.<br>These can be demonstrate with the help of transfer pricing documentation.              |
| Are record keeping penalties applicable if contemporaneous TP documentation is not prepared or submitted upon request?                                      | Taxpayers have to maintain business records to demonstrate compliance with ALP. If IRAS determines that such business records is inadequate then it can impose record keeping penalties.                                   |
| Are penalties applicable on TP adjustments made?  | Possibly, if you are considered by IRAS to have understated profits through improper transfer pricing. Penalties may not be limited to section 94(2).<br>May be section 95, section 96?                                    |

# Transfer Pricing adjustments

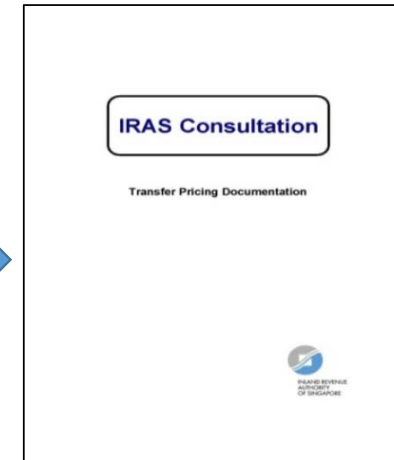
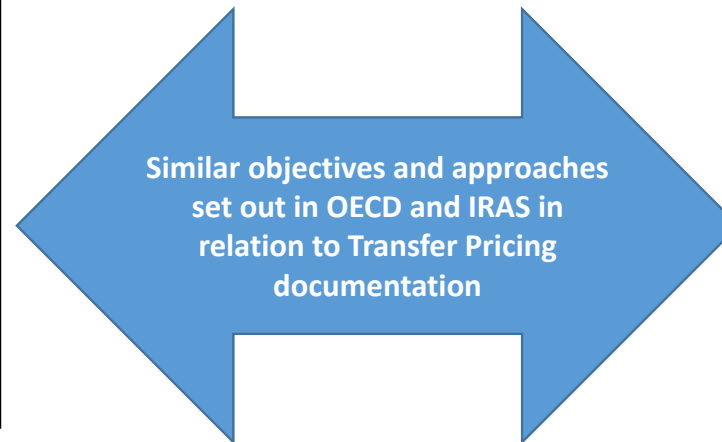
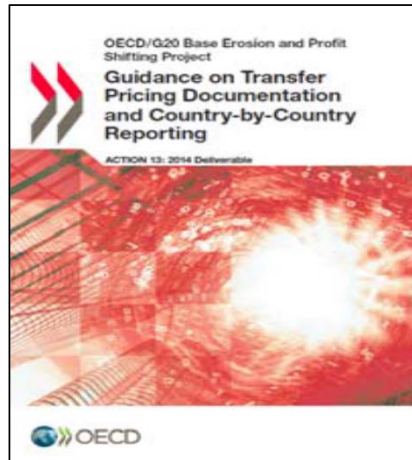


The IRAS has sets out its position on the various types of adjustments relating to transfer pricing and the conditions under which it would accept these adjustments

| Types of adjustments                                 | Adjustments made at / for |                            | Situations in which adjustments are made                     | Tax position                |                           |
|--|---------------------------|----------------------------|--|-----------------------------|---------------------------|
|  | Year end                  | Prior years                |  | Taxing of upward adjustment | Allow downward adjustment |
| Year-end adjustments at year end closing of accounts | ✓                         |                            | At closing of financial accounts / due to year end TP review | ✓                           | ✓                         |
|  |                           |                            |  | Conditions are met          |                           |
|  |                           |                            |  | ✓                           | ✗                         |
|  |                           |                            |  | Conditions not met          |                           |
| Compensating adjustments                             | ✓                         | ✓                          | Agreed in APA  | ✓                           | ✓                         |
| Corresponding adjustments                            | ✓                         | ✓ (Where roll-back agreed) | Agreed in MAP  | ✓                           | ✓                         |
| Self-initiated retrospective adjustments             |                           | ✓                          | Based on review of historical TP practices                   | ✓                           | ✗ (1)                     |

***(1) The IRAS will not allow any retrospective downward adjustments in the absence of contemporaneous TP documentation supporting the adjustments***

## How does IRAS' changes in TP documentation requirements tie in to the big picture?



- Alignment with the OECD update on transfer pricing documentation
  - Two tiered approach with master file (global level information) and local file (local entity level) information
  - IRAS will continue to monitor the international developments on TP documentation, including OECD's country-by-country reporting template
- Low value services: Reconciling OECD and IRAS guidelines
- Protection of Singapore's tax base

# What does this mean for taxpayers?



Global HQ (Singapore)

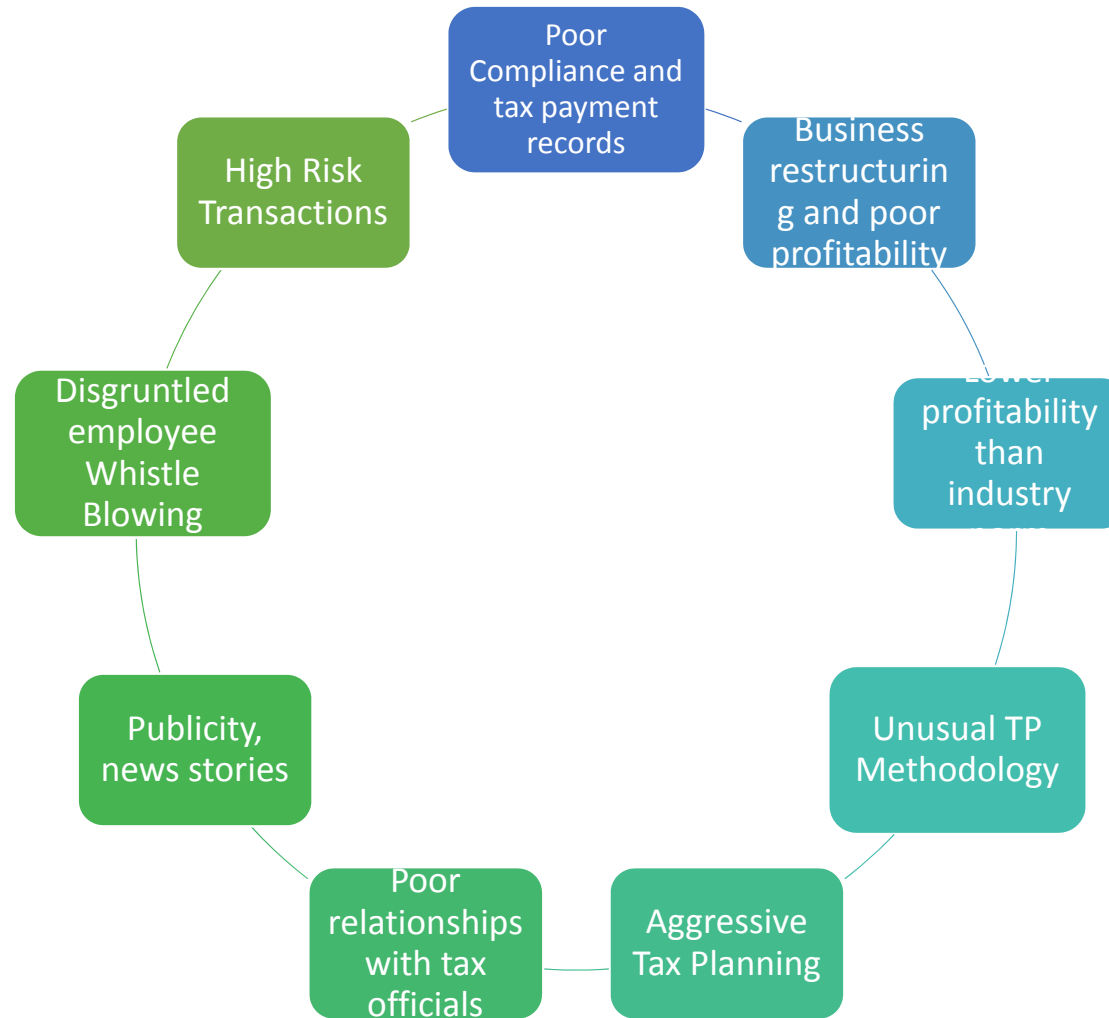
- Collate TP documentation requirements of all regions
- Prepares global Master file according to requirements
- Prepare Local file

100%

Subsidiary – located in UK

- Obtain Master file from global HQ/ regional HQ
- Prepare Local file

# Common Audit for Transfer Pricing



# What does this mean for taxpayers?



## Never prepared any formal TP documentation

- Assess your documentation needs (Global HQ/Regional HQ/Singapore subsidiary)
- Analyse gaps in TP documentation and policies
- Identify sources of information (e.g. HQ)
- Start preparing TP documentation and consider putting in place formal TP Policy

## Prepared TP documentation years ago

- Refresh analyses e.g. functional analysis, benchmarking studies
- Update with more information (e.g. value chain, supply chain) and prepare other pieces of documents (e.g. TP policy, intercompany agreement) in line with new Requirements

## Prepared TP documentation for latest financial year recently

- Evaluate gaps in information based on new requirements
- Prepare and maintain information that is not in the existing documentation (e.g. value chain, supply chain) separately or consider updating the documentation



# Risk Assessment



## Data Gathering

Collect financial data on quantum of related party transaction

## Application of thresholds, exceptions and risk assessment

Consider which categories of transactions require Singapore TP documentation  
For categories that do not exceed the threshold, consider whether the underlying tax risk is high and therefore means that Singapore TP documentation should be prepared

## Risk Assessment (cont..)



Reviewing existing TP documentation and contemporaneous documents relating to intercompany transactions / dealings

Prepare a gap analysis on aspects of existing TP documentation that need to be expanded and review other “internal” documents relating to intercompany transactions

Operational TP considerations

Review current year TP practices and results and consider whether periodic / year end adjustments are necessary

Prepare appropriate level of Singapore TP documentation

Prepare Singapore TP documentation by the date of submitting the applicable tax return

## Closing Remarks



- It is now a requirement to prepare contemporaneous transfer pricing documentation in Singapore. If transfer pricing documentation is not prepared then this may attract transfer pricing adjustments and penalties under the law and may have other broader implications.
- The Singapore Transfer Pricing Guidelines are broadly aligned with the proposals put forth in the OECD Action 13 report containing transfer pricing documentation.
- Singapore taxpayers should perform a risk assessment to assess documentation requirements and consider using a Masterfile approach if they have substantive overseas operations.

# Unprecedented focus on the morality of multinationals tax affair...



|  | Google      |             |             | Apple       |             |             | Starbucks    |              |              |
|--|-------------|-------------|-------------|-------------|-------------|-------------|--------------|--------------|--------------|
|  | 2012        | 2011        | 2010        | 2012        | 2011        | 2010        | 2012         | 2011         | 2010         |
| <b>Net revenues by Operating segment</b>         |             |             |             |             |             |             |              |              |              |
| Earnings before income taxes (US)                | 5311        | 4963        | 4948        | 23733       | 13538       | 7590        | 1679         | 1523         | 1308         |
| Earnings before income taxes (Rest of the world) | 8075        | 7633        | 5848        | 39883       | 26838       | 15306       | 379          | 287          | 128          |
| Total  | 13386       | 12596       | 10796       | 63616       | 40376       | 22896       | 2058         | 1810         | 1436         |
| <b>Taxes</b>                                     |             |             |             |             |             |             |              |              |              |
| US Taxes   | 2513        | 1998        | 2115        | 13317       | 7681        | 4366        | 546          | 406          | 538          |
| Foreign Taxes                                    | 358         | 248         | 167         | 713         | 602         | 161         | 77           | 37           | 38           |
| Total  | 2871        | 2246        | 2282        | 14030       | 8283        | 4527        | 623          | 443          | 576          |
| <b>Effective Tax Rate</b>                        |             |             |             |             |             |             |              |              |              |
| US ETR (state + federal taxes)                   | 47.3%       | 40.3%       | 42.7%       | 56.1%       | 56.7%       | 57.5%       | 32.5%        | 26.7%        | 41.1%        |
| <b>Foreign Effective Tax Rate</b>                | <b>4.4%</b> | <b>3.2%</b> | <b>2.9%</b> | <b>1.8%</b> | <b>2.2%</b> | <b>1.1%</b> | <b>20.3%</b> | <b>12.9%</b> | <b>29.7%</b> |
| Global Effective Tax Rate                        | 25.9%       | 21.8%       | 22.8%       | 28.9%       | 29.5%       | 29.3%       | 26.4%        | 19.8%        | 35.4%        |

Apple is being scrutinised by European officials, who accuse the company of using subsidiaries in Ireland to avoid paying taxes on revenue generated abroad. While apple generates about 60 percent of its sales outside the U.S., its foreign tax rate is 1.8 percent, according to Bloomberg Intelligence analyst Matt Larson →

*Amount in US \$ millions*