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IRAS publishes Guidelines for Commodity Marketing and Trading Companies

On 24 May 2019, the Inland Revenue Authority of Singapore (IRAS) released the e-Tax Guide (Guidelines) for Commodity Marketing and Trading Activities[1]. The release follows a consultation process between IRAS and taxpayers over the past few years.

Objective

The purpose of the Guidelines is to assist taxpayers who have commodity marketing and/or trading operations in Singapore to comply with the arm's-length principle. It includes hard commodities (e.g. metals) soft commodities (e.g. agricultural products) and transformed commodities (e.g. LNG). In line with IRAS' common practice, it defers to the Transfer Pricing Guidelines of Singapore, as well as the Organisation for Economic Co-operation and Development (OECD) in areas where this particular Guidelines are silent.

[1] Transfer Pricing Guidelines Special Topic – Commodity Marketing and Trading Activities (First Edition).

While the Guidelines outline the commercial reasons for setting up trading operations in Singapore, emphasis is placed on providing guidance on how to align various business models and the selection of appropriate transfer pricing methods. It is acknowledged that commodity marketing/trading can have very different levels of value-add which needs to be delineated by way of a proper functional and risk analyses. The Guidelines aim to provide some guidance by using the following business models which are often observed in practice as examples:

- Service providers
- Sales agents
- Low risk buy-sell distributors
- Sophisticated trading and supply chain management activities

The Guidelines endorse established concepts with respect to the assumption and allocation of risks (i.e. ability to control risk taken and financial capacity to address outcomes). They also provide some examples of relevant risks and how such risks may be controlled.

Key Observations

Based on our experience, the key area of contention for commodity trading operations is the transfer pricing method to be applied – this is addressed in detail in the Guidelines.

The Guidelines emphasize that "every effort should be made" to apply one of the five established transfer pricing methods. Singapore taxpayers applying a different transfer pricing method will likely be expected to provide convincing reasons as to why the traditional methods cannot be applied. In addition, taxpayers are expected to consider common pricing conventions in their industry when setting transfer prices (e.g. MOPS for refined oil products, JCC or Henry Hub pricing for LNG etc.). This aligns with IRAS' recent amendments to Section 34D of the Singapore Income Tax Act, where the concept of "arm's length terms and conditions" was introduced.

IRAS has not expressed a clear preference for any of the five transfer pricing methods. Instead, it has highlighted the scenarios/business models for which a particular transfer pricing method may be considered appropriate.

Given that there is quite extensive guidance on the CUP method, it would appear that taxpayers should consider its applicability before falling back on other transfer pricing methods. While taxpayers can use quoted prices on commodity exchange markets (e.g. London Metal Exchange) as a reference price, the actual pricing date agreed between the transaction parties can often be an area of dispute. Taxpayers are expected to have proper evidence on the pricing date as in its absence, IRAS may deem a transaction date based on other available information. This approach is in line with the recent revisions to the OECD Guidelines regarding commodity transactions.

In general, IRAS appears to be somewhat cautious with regards to the use of cost-based transfer pricing methods or profit level indicators, unless the trading/marketing activities are akin to that delivered by service provider. In other words, cost-based methods would unlikely be appropriate for sales agents, buy-sell distributors or sophisticated trading operations. Notably, the Australia Taxation Office (ATO) uses a cost-based approach for all types of foreign marketing/trading operations as an initial risk assessment tool. This is done by calculating a mark-up on the costs of the offshore marketing/trading operation and classifying the entity in a risk category from green (low risk) to red (high risk) accordingly.

Summary

The release of the Guidelines reflects the importance of the commodity trading industry for Singapore, as well as the increasing international debate on how to value the activities of intermediate marketing companies. In some way, it can be seen as Singapore's response to the guidelines published by the ATO on the same matter, which may prove useful for IRAS when engaging in bilateral negotiations in the future. It is unclear if and how the Guidelines will affect IRAS' positions for ongoing transfer pricing audits of commodity trading companies which have increased recently.

From a technical perspective, we are of the opinion that the views expressed by IRAS in the Guidelines are by design not prescriptive. This might be intentional so that the uniqueness of business models adopted by multinational companies can be properly considered.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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