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Sam Sim


Chang Yew Kwan


Kah Wai Lum

Sam Sim is the external senior adviser to the Global Tax Policy Center at the Institute for Austrian and International Tax Law of Vienna University of Economics and Business (WU). He is a member of Tax Analysts' board of directors and is based in Singapore. Chang Yew Kwan is the head of group tax with a banking group. Kah Wai Lum is the former Asia-Pacific head of tax with Barclays.

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In this article, the authors examine the upcoming transition away from LIBOR and associated interbank offer rates and consider the tax and transfer pricing issues that businesses in Singapore should prepare to address as the changeover approaches.

Singapore is the world's fourth most important financial center, following New York, London, and Hong Kong on the 2019 Global Financial Centres Index, the product of a survey conducted by the London-based think tank Z/Yen and the China Development Institute.[1]

Authorities in the United Kingdom have announced that LIBOR will not be sustained after 2021, and they have made it clear that the discontinuation of LIBOR is not a "black swan event" but rather a change for which the global financial markets can and should prepare.[2]

The U.S./Singapore dollar market is in the process of transitioning away from similar "IBOR" equivalents including the Singapore dollar swap offer rate (SOR) and the Singapore overnight rate average (SORA) rates. These are used in a wide range of financial instruments from simple cash market products to derivatives. Therefore, it is important to examine and understand the consequences of the transition for

[1] "Singapore Remains Fourth Best Financial Centre Worldwide," *Singapore Bus. Rev.*, Sept. 20, 2019.

[2] The comparison with "a remote probability 'black swan event'" appears to have originated in a speech by Andrew Bailey, chief executive of the Financial Conduct Authority, on July 12, 2018, titled "Interest Rate Benchmark Reform: Transition to a World Without LIBOR."

companies in Singapore, including the tax implications. However, the impact of the transition away from LIBOR and the associated interbank offer rates (IBORs) in Singapore will be much broader than just the Singapore dollar market. As a financial center, Singapore must deal with multiple currencies and jurisdictions, each with its own substitute reference rates (for example, Japan will move from the Japanese yen LIBOR to the Tokyo overnight average rate, also known as TONAR) as it continues to serve the funding and hedging needs across Asia. Transition arrangements are underway across the various currencies; in Singapore, the Monetary Authority of Singapore (MAS) and the Association of Banks of Singapore are leading these efforts, trying to facilitate a smooth switchover from the SOR to the new SORA, and more broadly, to ensure that the Singapore dollar interest rate markets continue to be robust, fair, and efficient going forward.

This article will examine the tax and transfer pricing implications of the transition and look at some of the operational changes that in-house tax directors will need to consider as they manage this transition.

I. Introduction

A. Background to the Transition

1. What Is LIBOR, or More Generally IBOR?

IBOR is the interest rate at which banks lend to and borrow from one another in an interbank market. LIBOR is more specific: It is the rate at which London banks lend to and borrow from one another. It is the most widely used interest rate benchmark in the world, and it underlies an estimated $350 trillion of outstanding contracts with maturities ranging from overnight to more than 30 years:

> LIBOR is not a single interest rate but an array of rates based on different currencies and different loan durations. It is produced for five currencies (the Swiss franc, the euro, the U.K. pound sterling, the Japanese yen, and the U.S. dollar) and seven tenors (overnight/spot next, one week, one month, two months, three months, six months, and 12 months) based on submissions from a reference panel of between 11 and 16 banks for each currency, resulting in the publication of 35 rates every applicable London business day.[3]

Singapore's equivalents to LIBOR are the Singapore interbank offered rate (SIBOR) and the SOR, which is a synthetic rate for deposits in Singapore dollars. The SOR represents the effective cost of borrowing the Singapore dollar synthetically, using the U.S. dollar rate for the same maturity, and then swapping out the U.S. currency for the Singapore dollar. These two rates underpin or affect much of the approximately SGD 677 billion of Asian currency unit lending to non-bank businesses (measured as of the end of 2019).[4]

2. Why Is LIBOR/IBOR Going Away?

A massive scandal involving efforts by many of the world's largest banks to manipulate LIBOR was uncovered in 2012.

Calculated daily, LIBOR supposedly reflects the interest rate that banks pay to borrow money from each other. Because it is the basis for determining the rates charged on many other kinds of loans and derivatives, it has a huge influence on the market price of those contracts.

LIBOR is a self-reported rate managed by the British Bankers Association (BBA), which means it depends on the reliability of the rates reported by a select group of banks. Some banks colluded to manipulate the rate, reporting artificially low or high interest rates to benefit their traders. "Because LIBOR is also used as an indicator of a bank's health, some banks were able to make themselves appear stronger than they actually were by reporting fictitious rates,"[5] a strategy that was particularly advantageous during the financial crisis of 2008 and 2009. In response to the scandal, the major banking regulators fined banks billions of dollars and the U.K. Financial Conduct Authority (FCA) no longer permitted the BBA to supervise LIBOR.

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[3] Julia Kagan, "The LIBOR Scandal," Investopedia, Mar. 25, 2019.

[4] According to MAS data available at Monetary Authority of Singapore, "Money and Banking."

[5] Kagan, *supra* note 3.

Replacements for LIBOR

	USD	GBP	Euro	Swiss Franc	Japanese Yen
ARR	SOFR (Secured Overnight Financing Rate)	SONIA (Sterling Overnight Interbank Average Rate)	ESTER (Euro Short-Term Rate)	SARON (Swiss Average Rate Overnight)	TONAR (Tokyo Overnight Average Rate)
Secured?	Yes	No	No	Yes	No
Overnight?	Yes	Yes	Yes	Yes	Yes

Later, the FCA announced it will only support LIBOR until 2021, and it will no longer compel banks to report rates. Thus, experts expect that LIBOR will sunset after 2021, noting that banks are leery of the liability that comes with reporting a rate that will continue to be viewed with suspicion.

Countries are already beginning to transition to alternative risk-free rates or alternative reference rates (ARRs) that will continue to affect a broad range of financial arrangements and products across all asset classes.

B. Alternative Risk-Free and Reference Rates

As discussed above, LIBOR covers five currencies and seven different maturities, all on an unsecured basis. For comparison, the table shows the ARRs that are replacing LIBOR for the same five currencies.

Out of the five ARRs, two are secured and three are unsecured. All five ARRs are on a one-day or overnight basis. *Ab initio*, the difference between a secured or unsecured rate is likely insignificant here because of the overnight tenor — an unsecured overnight rate is almost a risk-free rate. The bigger concern, however, is that to fully replace LIBOR, these ARRs must be extrapolated to obtain a refence rate for longer tenors of up to 12 months.

Working groups and those leading the shift to ARRs in different countries[6] have determined that compounded one-month, three-month, or six-month ARRs have a lower yield curve than the corresponding LIBOR benchmark for the same tenor. Hence, the various working groups are developing a term premium that can be added to the compounded ARR to obtain a more comparable replacement reference rate for longer-term LIBOR.

Determining a reliable term premium will be a challenge. As we discuss below, the result will potentially have tax, transfer pricing, and operational effects.

For Singapore dollars, SOR is an implied interest rate benchmark based on a foreign-exchange swap that is calculated using actual transactions in the U.S./Singapore dollar foreign-exchange swap market, including U.S. dollar LIBOR. A large volume of Singapore dollar interest rate derivatives reference SOR. SOR is also widely used in other Singapore dollar cash market products, such as business loans, syndicated loans, retail mortgages, and floating rate notes. Since SOR relies in part on U.S. dollar LIBOR, the upcoming discontinuation of LIBOR will affect the SOR's future sustainability.

The MAS has identified the SORA as the replacement for SOR in Singapore dollar derivatives and cash market products, and it has established a steering committee to oversee the transition.[7] As the name suggests, the SORA is the average rate from all unsecured overnight interbank Singapore dollar transactions brokered in Singapore. The MAS has published the SORA since July 2005. It is an unsecured rate.

Since SOR came in one-month, three-month, six-month, and 12-month tenors, fully replacing

[6]The Alternative Reference Rates Committee is managing the transition in the United States, the Sterling Working Group on Risk-Free Rates is in charge in the United Kingdom, and the Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks is overseeing Japan's efforts.

[7]Monetary Authority of Singapore, "MAS Sets Up Steering Committee to Drive the Interest Rate Benchmark Transition From SGD Swap Offer Rate (SOR) to Singapore Overnight Rate Average (SORA)" (Aug. 30, 2019).

SOR means that compounded SORA rates need to be computed for similar tenors. Therefore, the SORA may face the same issues mentioned above for ARRs generally.

C. LIBOR Transition and Accounting Standards

Some of the earliest responses to the LIBOR transition came from the accounting community. Both the International Accounting Standards Board and the Financial Accounting Standards Board issued announcements and amended their respective existing accounting standards: On September 26, 2019, the IASB issued proposed amendments to its international financial reporting standards and international accounting standards — namely IFRS 9, IAS 39, and IFRS 7[8] — and on November 13, 2019, FASB provided an accounting standards update.[9]

In brief, the known concerns and proposed changes in Singapore include[10]:

- classification and measurement arising from the modification of financial instruments;[11]
- accounting implications arising from the derecognition of a modified financial instrument;[12] and
- the impact that the shift away from IBOR will have on the hedge accounting requirements in IFRS 9 and IAS 39, including the potential that the changes lead companies to discontinue hedge accounting.[13]

Tax treatment in Singapore generally corresponds to the accounting treatment of an item of income and expense; thus, it is reasonable to expect that tax changes will follow any accounting changes. In the authors' experience, the Inland Revenue Authority of Singapore (IRAS) generally accepts that prepared financial statements are a fair representation of taxable income. Still, a review is needed to determine if these accounting changes lead to any mismatch between recognition of income based on accounting standards and the taxable income under the Singapore Income Tax Act (SITA).

II. Potential Tax Implications in Singapore

A. Responses From Other Jurisdictions

1. United States

The United States was one of the first countries to respond to the shift away from LIBOR. The Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (ARRC) in 2016 to identify best practices for developing alternative reference rates and ensuring contract robustness and to develop an adoption and implementation plan.

Likewise, U.S. tax authorities drafted guidance related to the phaseout of LIBOR. The IRS and the U.S. Department of the Treasury released proposed regulations (REG-118784-18) on October 9, 2019. These proposals address market concerns regarding the U.S. tax effect of the expected transition from LIBOR and other IBORs on both debt instruments and non-debt contracts, including swaps and other derivatives.

The proposed regulations address one of the key concerns regarding the change, namely whether replacing an IBOR reference rate in a debt instrument or non-debt contract with a different reference rate will result in a taxable exchange of the debt instrument or contract, which could potentially trigger U.S. tax liability for one or more parties. Under IRC section 1001, gain or loss is realized upon the exchange of property for property that differs materially in kind or extent. Specifically, for debt instruments, Treas. reg. section 1.1001-3 provides rules intended to help taxpayers measure whether particular modifications are economically significant, which would result in a deemed debt-for-debt exchange. For non-debt instruments, similar concepts apply under the fundamental change doctrine. The issue here is that the change in rates could amount to deemed taxable exchanges because it creates a significant

[8] IFRS, "IASB Amends IFRS Standards in Response to the IBOR Reform" (Sept. 26, 2019). *See also* IFRS, "IBOR Reform and Its Effects on Financial Reporting — Phase 2" (last accessed Apr. 13, 2020).

[9] FASB, "FASB Approves Finalization of Guidance to Assist in Transition Away From Interbank Offered Rates to New Reference Rates" (Nov. 13, 2019).

[10] *See, e.g.*, IFRS, "Interest Rate Benchmark Reform — Amendments to IFRS 9, IAS 39 and IFRS 7" (Sept. 2019).

[11] IFRS, "IBOR Reform and Its Effects on Financial Reporting — Phase 2: Classification and Measurement — Modification of Financial Instruments," Staff Paper (Oct. 2019).

[12] IFRS, "IBOR Reform and Its Effects on Financial Reporting — Phase 2: Accounting Implications From Derecognition of a Modified Financial Instrument," Staff Paper (Oct. 2019).

[13] IFRS, "IBOR and Its Effects on Financial Reporting — Phase 2: Hedge Accounting," Staff Paper (Dec. 2019).

modification. Therefore, the rate change could generate capital or ordinary gains or losses for debt holders, and corresponding ordinary interest expense or ordinary income for debt issuers, because of the resulting cancellation of debt.

The new proposed regulations provide certainty that, at least under specified circumstances, the rate replacement will not result in a taxable event. They also provide transition guidance on other matters potentially affected by the rate change, such as the calculation of interest expense for a foreign bank with a U.S. branch.

2. United Kingdom

In the United Kingdom, taxpayers are considering whether material changes to existing contracts may constitute a disposal of the existing contract and entrance into a new contract for corporation income tax purposes. The reissuance or amendment of some contracts, such as might result from the replacement of intragroup LIBOR funding rates with other measurements, could also have negative implications in connection with interest deduction limitation rules and thin capitalization rules.

B. Income Tax Implications in Singapore

Singapore does not have thin capitalization rules.

Because the interest rate change typically affects the measurement (including valuation) and presentation of financial instruments and payments thereon, most of the tax issues in Singapore will involve the classification of taxable income and expenses or will involve transfer pricing.

1. Withholding Tax

In terms of withholding tax, there should not be any changes resulting from whether an instrument or contract references SOR or SORA. Banks and approved financial institutions that have blanket withholding tax exemptions will continue to be covered during the transition from SOR to SORA. For nonfinancial institutions, companies that have interest payments subject to withholding tax should continue to pay withholding tax on the new SORA-referenced rate. Any one-time adjustment payment is also likely to be subject to withholding under section 12(6) of SITA given the broad nature of the relevant clause: "any other payment in connection with any loan or indebtedness."

For companies that have specific loans for which the finance minister has granted a withholding tax exemption under section 13(4) of SITA — that is, when the company's income involves the promotion or enhancement of economic or technological development in Singapore — the change may present a few issues. Depending on the extent of the change to the loan agreement — specifically, whether it amounts to a complete replacement or substitution of the original loan agreement (a distinction discussed in the next subsection) — the taxpayers may need to resubmit the amended loan agreement to the Ministry of Finance for approval to continue enjoying the withholding tax exemption. Also, any one-time adjustment payment or any other adjustment to compensate for the difference in value under the old versus new rate may not be covered under the original withholding tax exemption order, depending on the precise text of the original order. Hence, companies should carefully review their original order and ascertain whether it is necessary to approach the MOF or any other relevant agencies to achieve certainty on the scope of the withholding tax exemption for both any one-time adjustment payments and the revised (or new) loan agreement.

2. New Loan or Existing Loan?

More generally, an a priori question is whether the replacement of SOR with SORA results in an instrument or contract becoming a different loan or whether it remains the same loan and is just amended.

If the move to SORA is merely a change in some terms of the loan, a party might argue that it is essentially the same loan and there is no replacement or refinancing of the loan. However, if the existing loan arrangement is terminated and replaced by a new loan agreement, it is likely to be considered a refinanced loan. If the interest on the previous loan was deductible, to continue to benefit from the same treatment, the borrower would need to prove to the IRAS that it used the new loan solely to repay the previous loan.

3. Tax Treatment of a One-Time Payment

If the corporate borrower makes a one-time transition payment to a bank, a tax deductibility issue would arise. Since this payment is likely compensatory in nature — that is, it accounts for the difference in present value under the new rate versus the old rate — a corporate borrower may have a hard time convincing the IRAS that it is interest, even though the payment arises from a difference in rates. Therefore, the borrower would have to consult the Schedule to the Income Tax (Deductible Borrowing Costs) Regulations 2008 to determine if the one-time payment could qualify under any of the categories of deductible borrowing costs. The one-time payment might fall within the definition of "conversion fees or amendments fees" or "cancellation fees," depending on whether the loan is amended or it is canceled and replaced with another loan.

If the bank needs to make a transition payment to the corporate borrower, interesting issues may arise from the corporate borrower's perspective. This situation could result in the bank offsetting the adjustment against future interest payments. Since this adjustment of interest charges would be prospective, it is unlikely to lead to any new tax issues.

If the interest on the loan was not tax deductible, there is a strong argument that the borrower should not be taxed on the receipt of this payment because it is capital in nature and not related to an expense for which a tax deduction had been allowed previously.

However, if the interest on the loan was tax deductible previously, it will be more difficult for the corporate borrower to convince the IRAS that the transition payment should not be taxed. While the corporate taxpayer can argue that the one-time payment is capital in nature and that it is not meant as a reduction or refund of past interest that was tax deductible, it is likely that the one-time payment amount is based on the higher interest cost of the replacement loan resulting from the change to SORA. If so, the IRAS may take the position that the borrower should use the one-time payment to offset the prospective interest expense, and therefore the corporate borrower should only get a tax deduction for the prospective interest net of the one-time receipt. It is unclear whether the entire one-time payment should be taxed upfront or amortized over the duration of the replacement loan.

It is harder to argue for taxing the one-time payment in the hands of the corporate borrower if the corporate taxpayer chooses not to take on a replacement loan and obtains internal funding instead.

It will be interesting to see how the authorities resolve these issues.

C. Goods and Services Tax

Under the fourth schedule of the Goods and Services Tax Act, the provision of any loan or credit is an exempt supply. By the same principle, any payment directly related to a loan or credit — such as interest — should also be exempt from GST, assuming the recipient is a local establishment.

Thus, the transition from SOR to SORA should not result in any GST issues regardless of whether it leads to a new loan or an amended version of an existing loan. As for the one-time payment or adjustment, it should also qualify as an exempt supply, assuming it is clear that the payment is not compensation for the provision of any service or advice from the lender to the borrower.

D. Transfer Pricing

The transition raises several interesting issues in transfer pricing.

1. Updating Legislation and Guidance

First, to the extent there are explicit references to LIBOR, U.S. LIBOR, SIBOR, and so forth in Singapore's tax legislation or guidance — for example, paragraph 13.18 of the IRAS E-Tax Guide: Transfer Pricing Guidelines (5th Edition) states, "The base reference rate is usually a publicly available rate such as the Singapore Inter Bank Offered Rate ('SIBOR'), the London Inter Bank Offered Rate ('LIBOR') or prime rates offered by banks" — they need to be updated. The updates should take into consideration whether instruments that reference LIBOR, SIBOR, or related rates should, from a policy perspective, be grandfathered or, going forward, should be presumed to be prima facie noncompliant for not using SORA. Taxpayer certainty can be enhanced by transitional provisions or guidance as to the tax treatment of renewal of instruments that use the older reference rates and financing arrangements that straddle the change-over period.

Likewise, taxpayers may opt to apply the safe harbor indicative margin for a related-party loan not exceeding SGD 15 million in accordance with the administrative practice that IRAS lays out in paragraph 13.28 et seq. of its transfer pricing e-guide. While the safe harbor is broadly worded and does not provide a specific reference rate, the relevant paragraphs contain references to SIBOR and LIBOR; these need to be reworded, and any taxpayer relying on those for a safe harbor rate must recalibrate them to SORA. There is also a question whether benchmark rates from other countries may be acceptable or comparable if they depart from the original reference rate — for example, if the old rate was an unsecured rate and the new rate is a secured rate. There may be added complications if those other countries continue using LIBOR or rely on a version of it. Specifically, the issue in those cases is whether the IBOR rates can still be relied upon to compute the indicative safe harbor margin.

2. Recalibrating New or Amended Contracts

Traditionally, LIBOR has been widely used to set interest rates, guarantee fees, and much more. Intercompany transfer pricing policies and intercompany loan, deposit, and guarantee agreements that used LIBOR must be recalibrated to the new SORA, which will be particularly challenging when the changeover is tantamount to entering into a new financing agreement.

As discussed previously, the transition does not always need to result in a new instrument or contract. The preexisting agreement may include clauses — or it may be possible to write in clauses — that enable the switchover to the new rates, including any adjustment payments if necessary. Still, in some cases, the change may be material, resulting in the old agreement ending and a new one taking its place.

In either case, one challenge will be determining when the switchover happens — for example, in floating rate instruments, the timing of the switchover must be specifically defined so that the appropriate rates are locked in and considered. Cross-currency pairs — such as euro/Japanese yen or Singapore dollar/Japanese yen — may give rise to additional complications.

Further considerations from a transfer pricing perspective include whether the transfer pricing method used continues to be applicable to the new SORA rate and whether the old LIBOR-based range continues to be arm's length when compared with a refreshed SORA-based range of interest rates. Issues could also arise from the divergence between SORA and other reference rates, such as the U.S. secure overnight financing rate, including to what extent benchmarking efforts, a two-sided exercise, should consider these divergences when computing the arm's-length range. Similarly, to what extent should the varying degrees of risks and volatility in different reference rates be considered? What about financing involving counterparties from countries that have controlled interest rates? Finally, to the extent that the new alternative reference rates (not just SORA) do not yet have a full or reliable yield curve across the difference tenures, this could present challenges for the recalibration analysis.

3. Transfer Pricing and Changeover Costs

The recalibration should include a changeover or adjustment fee to account for the difference in value of the instrument or interest payments under the old rate versus the new rate. Consequently, there should also be an arm's-length remuneration or compensation for this difference in value. As discussed above, there could be tax characterization issues regarding the adjustment amounts, including whether it should be capitalized or amortized over the period of the contract.

4. Classification as Old Debt or New Debt

The duration (or term) of the instrument and the point in time when arm's-length interest is computed affects the version of the law that is applicable. If the change from LIBOR to SORA amounts to the issue of a new instrument rather than a rollover of old debt, the instrument's duration and reference point for the law applicable to each period may change. This may have implications for the thin capitalization analysis and antiavoidance challenges involving long-term debt pushdown arrangements.

5. Operational Transfer Pricing

Regional or global treasury centers will need to reexamine existing intercompany financial agreements and transfer pricing policies to the extent that they rely on IBOR or LIBOR.

E. Stamp Duty

Under the first schedule of the Stamp Duties Act, Chapter 312, instruments chargeable with stamp duty include instruments relating to the sale of any stock, shares, or any interest therein. Consequently, if the transition results in the conveyance of, for example, a convertible preferred stock for which returns are computed based on IBOR, there may be stamp duty payable.

III. Conclusion

In addition to updating the affected legislation and guidance, it would be helpful for the tax authorities to clarify the tax consequences of the transition to LIBOR when it may be unclear. As described herein, areas of uncertainty include the treatment of any new instrument arising from the transition and tax treatment of any adjustment amounts paid as a result of the change.

The MAS could use circulars or enact policies to provide clarification regarding the accounting and tax treatment of any income, expenses, or costs arising from the transition in the circulars and policies of the MAS. To build the yield curve, it would be beneficial for the MAS to encourage the issuance of SORA and other new, alternative reference-rate-based instruments.

In any event, with the transition away from LIBOR rapidly approaching alongside the finalized transfer pricing guidance for financial transactions that the OECD issued on February 11,[14] now is a good time to invest resources in reviewing and understanding the implications of the transition and beefing up tax and transfer pricing documentation in anticipation of the change. ■

[14] OECD, "Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS: Actions 4, 8-10" (Feb. 2020).