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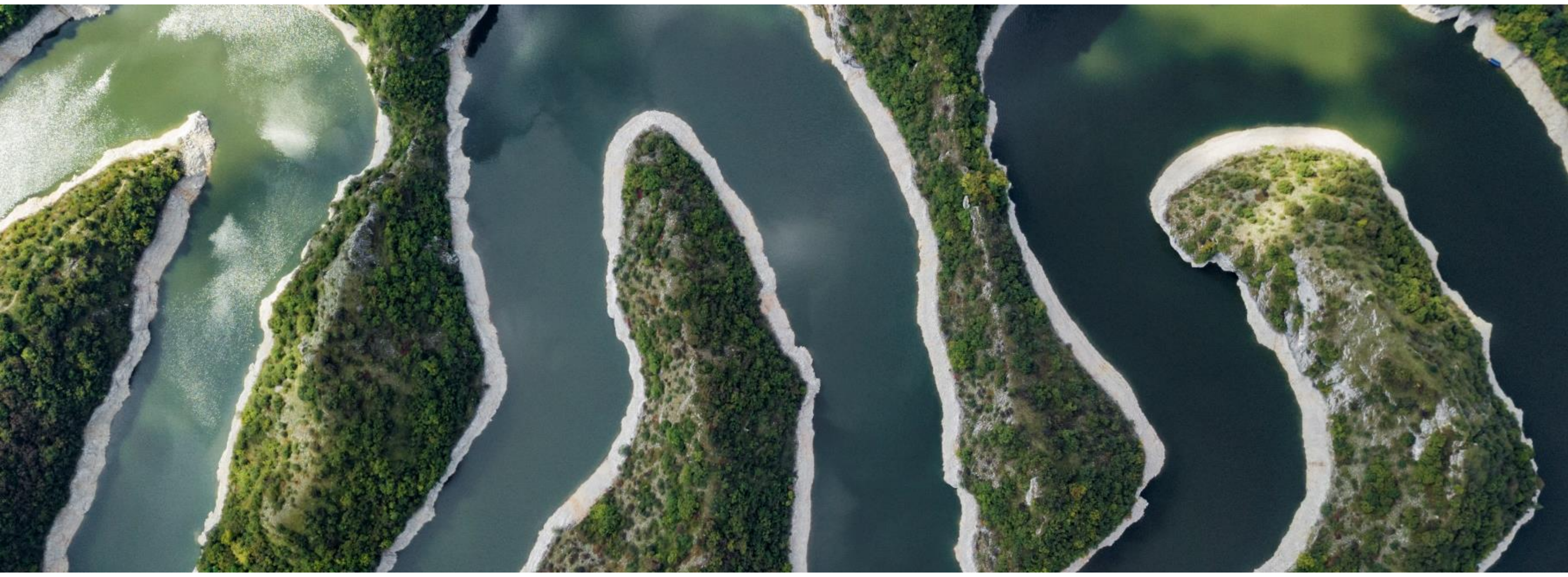

Tax news flash - February 2021

Release of the OECD Guidance on the transfer pricing implications of the COVID-19 pandemic

Introduction

On 18 December 2020, in order to address a response to the transfer pricing issues resulting from the coronavirus (also referred to as “COVID-19”) pandemic, the OECD released a new guidance. Its aim is to help tax administrations and multinational enterprises (“MNE”) to solve transfer pricing issues that could result from the pandemic. This new guidance is not replacing the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration 2017 (“OECD TPG”) but rather providing solutions on the application of the OECD TPG following the COVID-19 consequences on the global economy.

The guidance articulates around 4 topics:

- Comparability analysis;
- Losses and allocation of COVID-19 specific costs;
- Government assistance programmes; and
- Advance pricing agreements (“APAs”).

Comparability analysis

Before performing a comparability analysis for financial year 2020, it is important to analyse whether the current economic circumstances had an impact on the delineated transactions. Another point of attention is to analyse if in comparable circumstances, independent parties would have tried to renegotiate the prices.

The guidance explicitly recommends the use of any form of publicly available information regarding the effects of the COVID-19 when determining a transfer pricing policy in 2020. Various sources of information may be used to assess the arm's length nature of the prices to be applied, for example an analysis of the impact of the COVID-19 on the sales volumes of the taxpayer or specific industry indicator. A comparison between budgeted financial information before the crisis and the financial results effectively achieved can also be used to assess the impact of the pandemic on the transfer prices.

To address information differences regarding the COVID-19 impacts to the tax administrations, the OECD recommends different solutions. The taxpayers could use more than one transfer pricing methods to determine an arm's length price or the use of an outcome testing approach. The use of contemporaneous information and comparables and their effects on the transfer prices is also recommended. This would need to be documented in the transfer documentation.

If in ordinary circumstances it is recommended to use multiple years data, the OECD points out that, in the pandemic context, it may be appropriate to use separate testing periods. When performing a benchmark analysis, care should also be taken when analysing the comparables to be used. As all companies did not face the crisis in the same way, adjustments should be necessary.

Losses and allocation of COVID-19 specific costs

According to the chapter IX of the OECD TPG, the activities performed by of a company can be characterised as "limited-risk". In the pandemic context, those entities might be in the position where they would need to incur losses. The OECD recommends to carefully delineated the nature of the risks that are assumed by a "limited-risk" company. The use of an appropriate transfer pricing methodology will evaluate the extent of the losses that can be supported by the company.

The pandemic may also lead independent parties to renegotiate their agreements. Associated parties could also consider revising their intercompany agreements to reflect the consequences of the COVID-19. If so, any modification in the intercompany agreements should be well supported with transfer pricing documentation.

The delineation of the controlled transaction is also a key element when determining the allocation of operational or exceptional costs resulting from the pandemic. An analysis should be performed to determine which party is supporting the costs in relation to a particular risk.

When performing a comparability analysis, the exceptional costs arising from the COVID-19 could be treated in different ways. For instance, they could be excluded from the net profit indicator if they relate to the controlled transaction.

Taxpayers may also seek to invoke force majeure clauses to justify the non-performance of a contract. A careful review and delineation of the controlled transaction is needed to assess if the COVID-19 constitutes a force majeure. It is also important to analyse whether at arm's length a party would have invoked force majeure in comparable circumstances. OECD recommends to the tax administrations to carefully review the assertions where a force majeure clause has been invoked.

Government assistance programmes

The guidance addresses specific answers on how to deal with government assistance. The OECD recommends to first evaluate if the government assistance received by a company is a relevant economic characteristic. If yes, the taxpayers should reflect this information in his transfer pricing documentation and analysis.

Regarding the impact of the receipt of a government assistance on the prices of controlled transactions, a strong comparability analysis as well as the identification of the economically relevant characteristics of the transaction are needed. This will allow to evaluate whether the receipt of government assistance would affect the price of an intercompany transaction. The government assistance received should not modify the allocation of risk from a transfer pricing point of view.

Government assistance may also need to be considered when performing a comparability analysis. As the impact of the COVID-19 differs depending on the markets, the comparables will be affected as well. Additional challenges may arise from this situation and could lead to the use of more than one transfer pricing methodology when evaluating the impact of government assistance.

Advance Pricing Agreements

The existing APAs should be maintained despite the pandemic situation, unless there is a condition leading to their cancellation or revision. The current economic situation does not constitute a breach of a critical assumption as stated by the OECD. Unilateral changes should be avoided, and any modification to the terms and conditions of an APA should result from a discussion between the taxpayer and the relevant tax administration.

The OECD also address an answer to the tax administrations on how to deal with the failure to meet critical assumptions. Three solutions are indicated: the revision of the existing APA; the cancellation of the APA or its revocation. The taxpayer should notify the tax administration, as soon as possible and supported it with a relevant documentation.

With respect to the APAs that are under negotiation, the OECD recommends a flexible approach to limit the delay in the negotiation. One of the solutions could be to insert conditions in the APA that the impact of the COVID-19 will be analysed and reported once they are known.

Our transfer pricing team is at your disposal should you have any questions relating thereto or should you need assistance to assess impacts on your business.

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