



OECD Guidance on Transfer Pricing implications of Covid-19 pandemic

On 18 December 2020, the Organisation for Economic Co-operation and Development (OECD) issued the much-awaited guidance on Transfer Pricing implications of Covid-19 pandemic that provides broad principles for taxpayers in reporting the financial periods affected by the pandemic and for tax administrations in evaluating the implementation of taxpayers' Transfer Pricing policies.

Primarily, the guidance focuses on the following 4 significant challenges that businesses across the world might or would face in complying with their local Transfer Pricing compliance requirements because of the ongoing pandemic:

Comparability analysis

Losses and the allocation of Covid-19 specific costs

Government assistance programmes

Advance Pricing Arrangements

I. Comparability Analysis

The extraordinary changes in the economic environment following the outbreak of Covid-19 have created certain unique issues while performing comparability analysis, especially, reducing the reliance that could be placed on historical comparable data as the same would be highly distorted due to significant changes in the operations, profitability, and pricing policies of most of the companies.

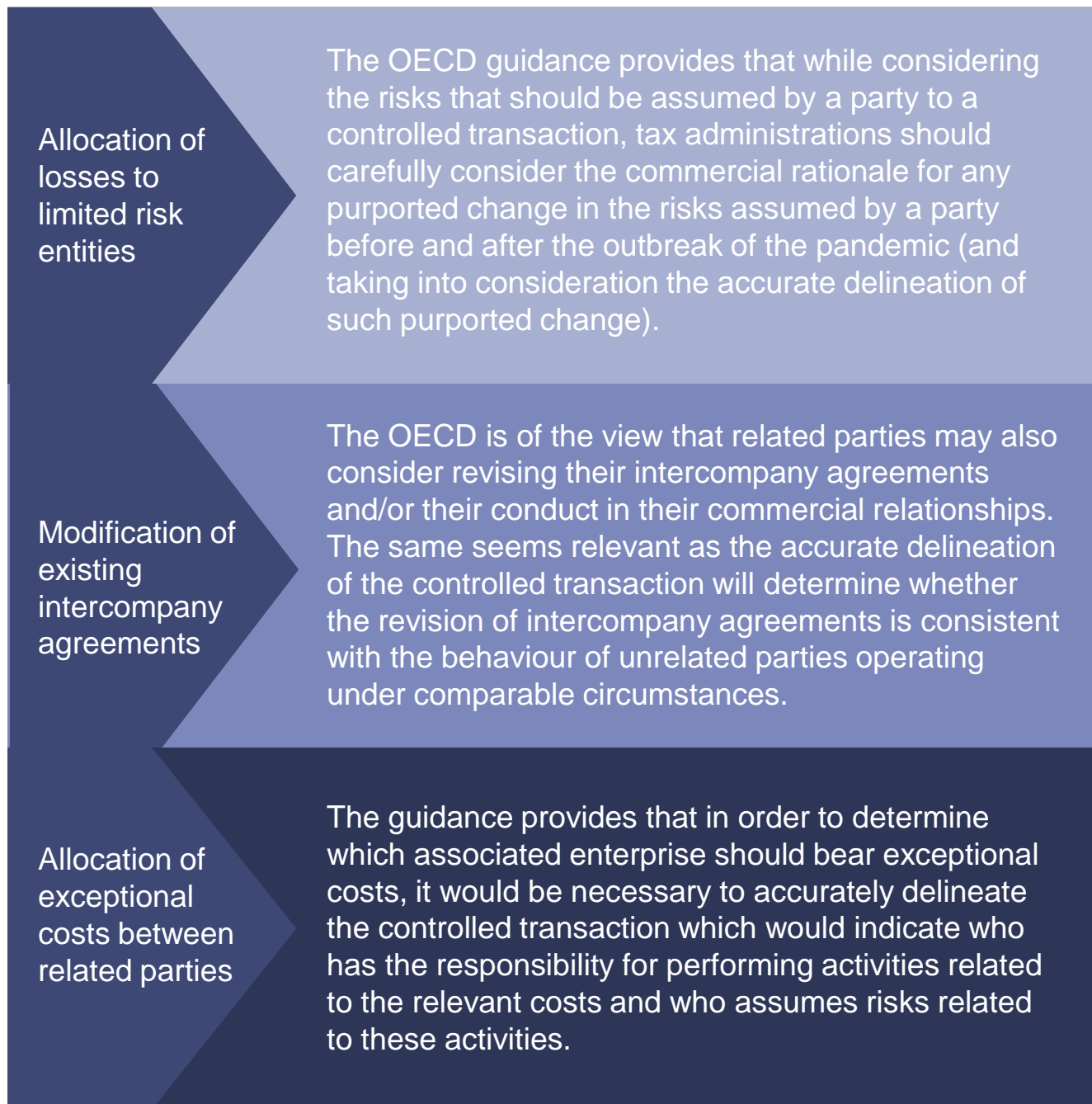
As a result, taxpayers and tax administrations may have to work out different practical approaches that can be adopted to ensure a robust comparability analysis that is compliant and consistent with the Transfer Pricing principles and regulations of the local tax jurisdiction. Some of such approaches addressed by the OECD in its guidance cover the following:

- Various sources of information to support the comparability analysis
- Practical approaches for addressing information deficiencies including:
 - Use of reasonable commercial judgement supplemented by contemporaneous information
 - Arm's length outcome testing approach
 - Use of more than one Transfer Pricing method
- Separate testing periods of data could be used for determining arm's length price and proper treatment of government intervention schemes/aids
- Inclusion of price adjustment mechanisms in controlled transactions
- Use of loss making comparable

II. Losses and allocation of Covid-19 specific costs

Due to the pandemic, many Multinational Enterprise (MNE) groups incurred losses due to a decrease in demand, disruptions in supply chain or operations, inability to obtain or supply products or services or due to exceptional, non-recurring operating costs. As a result, the allocation of losses between associated entities could give rise to potential tax disputes.

The OECD in its guidance has addressed the above in the following 3 aspects:



Impact of force majeure clause on allocation of losses

Due to the ongoing pandemic, some taxpayers may seek to assert force majeure in situations where it is not contained within the relevant intercompany agreement or may seek to change an existing intercompany agreement to insert a force majeure clause or may seek to assert that a renegotiation at arm's length would have similar economic outcomes.

Thus, in such situations, the OECD guidance suggests that tax administrations should carefully review such assertions in light of the accurately delineated transaction (including consideration of the conduct of the parties, both past and present) and the economically relevant circumstances of the transaction.

III. Government Assistance Programmes

The OECD guidance propagates that the terms and conditions of government assistance programmes related to Covid-19 need to be considered when determining the potential impact of these programmes on controlled transactions and when comparing their effects with those of other pre-existing assistance programmes. Moreover, the analysis required on the specific characteristics of the government assistance should take into account the economic impact of the assistance on the accurately delineated transaction.

Thus, the determination of the economic relevance of government support will have an impact on the accurate delineation of the controlled transaction and performing the comparability analysis. If the government assistance is an economically relevant characteristic, this information should be included as a part of the documentation to support the transfer pricing analysis.

The OECD also suggests that if the taxpayer is applying a one-sided method such as the resale price method, the cost-plus method, or the TNMM, the accounting treatment of the government assistance in both the tested party and any comparable may need to be specifically identified, especially when the tested party and the comparables apply different accounting standards.

IV. Advance Pricing Arrangements (APA)

The OECD suggests that taxpayers who may face challenges applying existing APAs under the present economic conditions should adopt a collaborative and transparent approach by raising these issues with the relevant tax administrations in a timely manner. Taxpayers should not seek to resolve them unilaterally without consulting with the relevant tax administrations.

Moreover, most APAs include critical assumptions about the operational and economic conditions that will affect the transactions covered by the APA. The pandemic and the response of governments have dramatically affected the economic and market conditions and are likely to qualify as a breach of the critical assumptions.

However, the OECD is of the view that a mere change in business results during the period affected by the pandemic would not, however, result in a breach of a critical assumption (unless the particular APA had a critical assumption regarding changes in business results). Thus, if tax administrations establish that the critical assumptions of an APA have not been breached, the existing APA, as agreed, must continue to be respected, maintained and upheld.

To conclude, taxpayers and tax administrations negotiating APAs that are intended to cover Financial Year 2020 are encouraged to adopt a flexible and collaborative approach to determine how to take into account the current economic conditions, and the various options available in relation to the revision of existing APAs.



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