

**TRANSFER PRICING
& COVID-19:
2020 YEAR-END
CONSIDERATIONS**

17 DECEMBER 2020

POLLING QUESTION



- ❖ Has your organisation already implemented TP adjustments in light of the COVID-19 pandemic in 2020?

Yes, we considered the impact of COVID and made adjustments

No, we adjusted in line with our existing TP policies only

No, we haven't adjusted our 2020 transfer prices

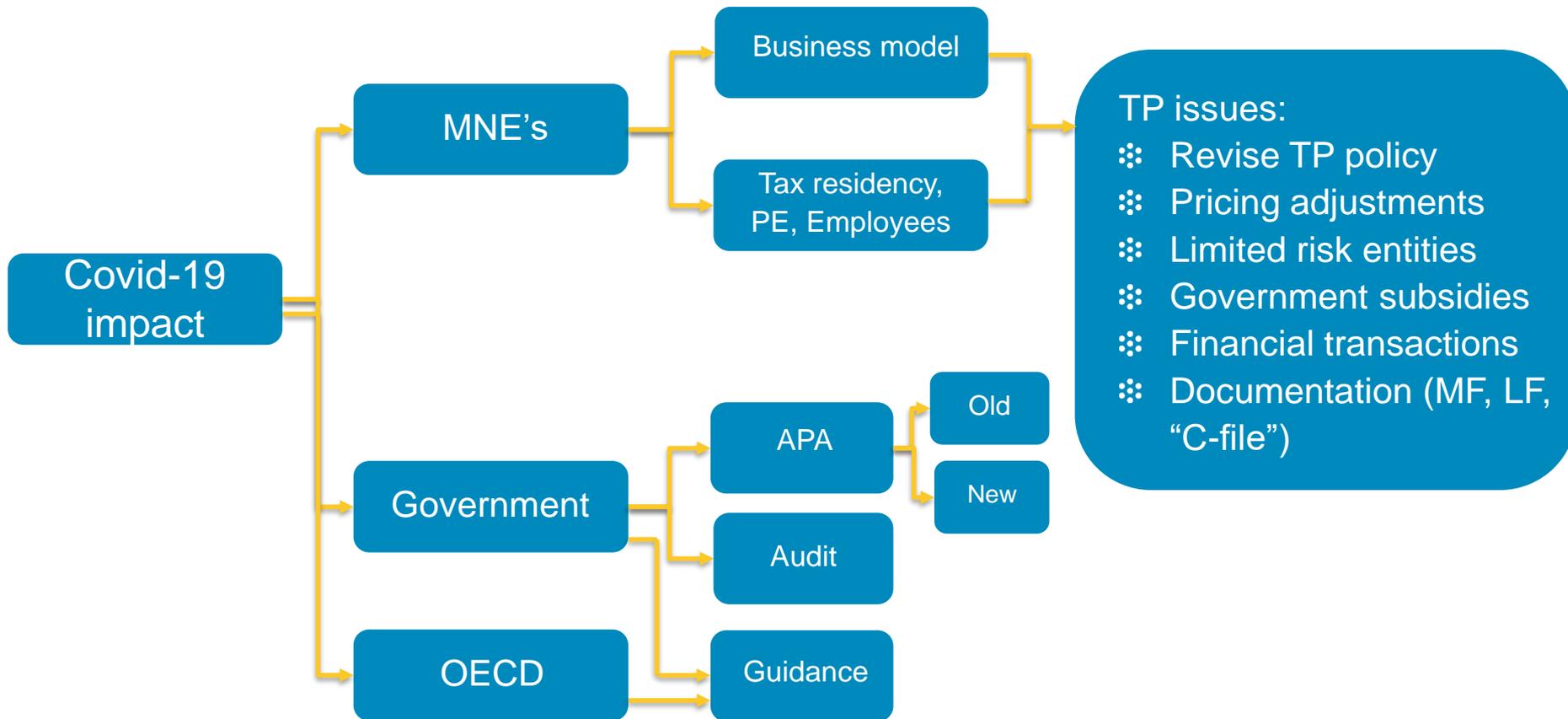
Not yet, we are awaiting further guidance

AGENDA: THE KEY QUESTIONS



- ❖ What impact does the Pandemic have on an MNE's business, both on a global level and an entity level?
- ❖ Are the current transfer pricing policies still reflective of business operations or should they be revised?
- ❖ What would third parties do to overcome the effects of the Pandemic?
- ❖ Should MNEs renegotiate their transfer pricing arrangements as third parties would?

TP IMPACT FLOW CHART



OECD GUIDANCE



- ❖ Previous Guidance March 2020
 - Duration Covid-19 Crisis unknown at that time!
- ❖ New OECD Guidance expected in December 2020 or early 2021
- ❖ If no consensus: unilateral approaches



**COVID IMPACT
ON BUSINESS
MODELS**

THE IMPACT ON MNES



Royal Dutch Shell PLC [+ Add to myFT](#)

Shell to cut up to 9,000 jobs in effort to shave \$2.5bn in costs

Pandemic adds to challenges facing industry grappling with shift to cleaner energy



Nike Inc [+ Add to myFT](#)

Online sales surge sends Nike shares to record high

Sportswear group finds ecommerce makes up for lower foot traffic at reopened stores



The company says some of its best-selling products included its Air Max 90 shoe, and a newly launched line of yoga apparel © Getty Images

Volkswagen AG [+ Add to myFT](#)

VW's MAN tears up deal with German unions as it pursues job cuts

Truck and bus manufacturer warns of 'perfect storm' as it cancels agreement, axe 9,500 roles



Property sector [+ Add to myFT](#)

Destruction of value in US real estate revealed

Commercial properties in difficulty are being valued at less than 75% previous level, appraisal data show



Commercial property [+ Add to myFT](#)

Debt collectors bulk up to deal with US property loan defaults

Rise in distressed commercial mortgages puts special servicers in demand



The onset of coronavirus and worldwide lockdowns have plunged a vast number of commercial properties into jeopardy © AFP via Getty Images

Opinion Lex [+ Add to myFT](#)

Travel sector: countdown to a fire sale

It will be wiser to accept the world has changed than hold out in hopes of a full recovery



New Covid-19 lockdowns could trigger a sale of travel industry assets: planes, ships and hotels © REUTERS

UNDERSTANDING THE IMPACT OF COVID



- ❖ The impacts will vary by industry and business, with no singular trend.
- ❖ This will require careful analysis of temporary versus long-term changes to operating models.



↳ Events

- ❖ Shut down
- ❖ Supply chain disruption
- ❖ Lower demands

↳ Actions

- ❖ Cash management
- ❖ Government aid

↳ Events and consequential actions may be different per industry

- ❖ Adjustment to COVID reality
- ❖ E-commerce
- ❖ Re-evaluate need for physical office space
- ❖ Substantial job reductions
- ❖ Relocation of activities



**TP ISSUES FOR
CONSIDERATION**

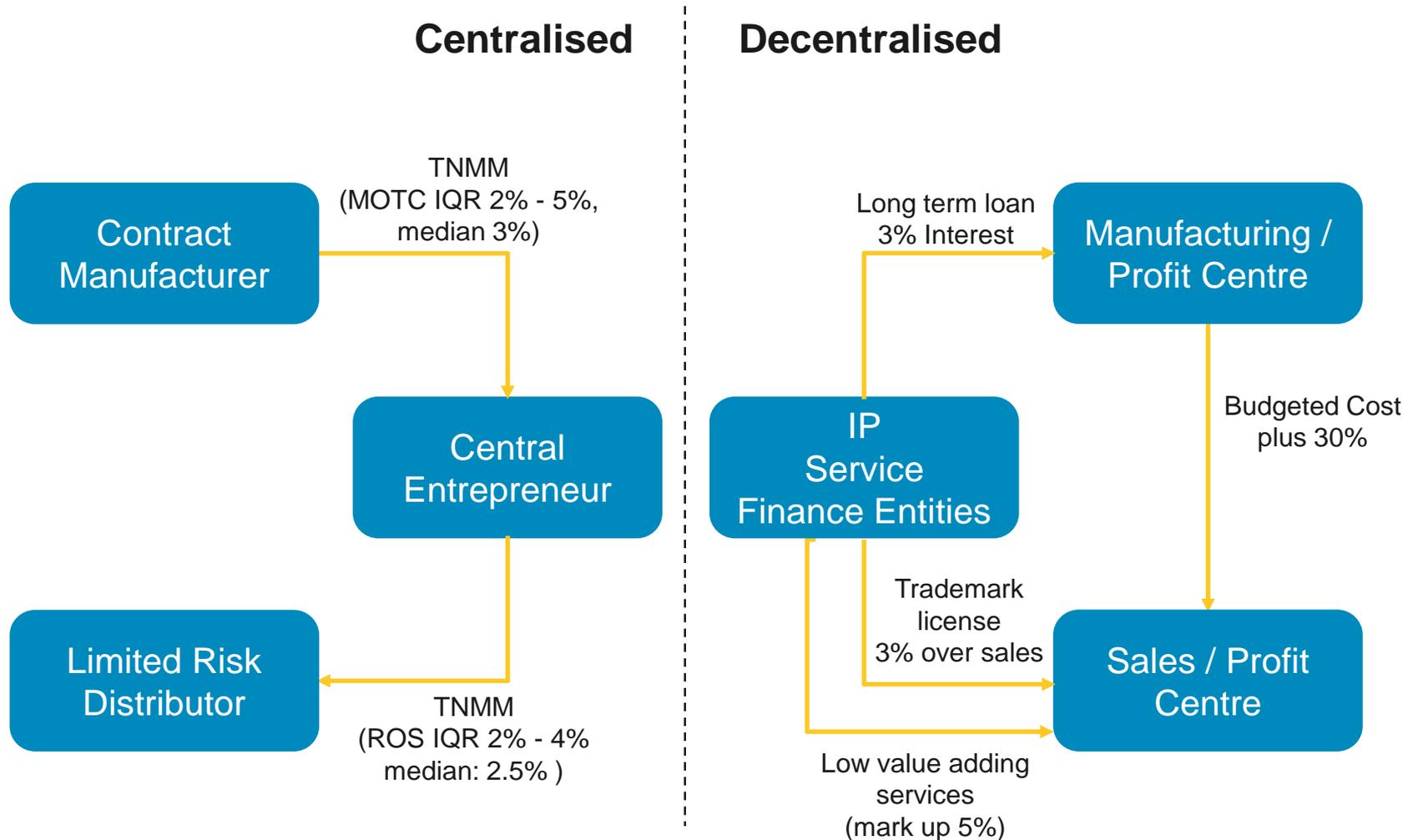
OECD TPG CONSIDERATIONS

Par 1.110 OECD-TPG: Economic circumstances need to be taken into consideration as they may have a material effect on price.

Par 1.129 OECD-TPG: “...Of course, associated enterprises, like independent enterprises, can sustain genuine losses, whether due to heavy start-up costs, **unfavourable economic conditions**, inefficiencies, or other legitimate business reasons...”

Par 3.68 OECD-TPG: “...information relating to the conditions of comparable uncontrolled transactions undertaken or carried out **during the same period** of time as the controlled transaction (contemporaneous uncontrolled transactions) is expected to be the most reliable information to use in a comparability analysis...”

SAMPLE BUSINESS MODEL



BASIS FOR PRICING ADJUSTMENTS



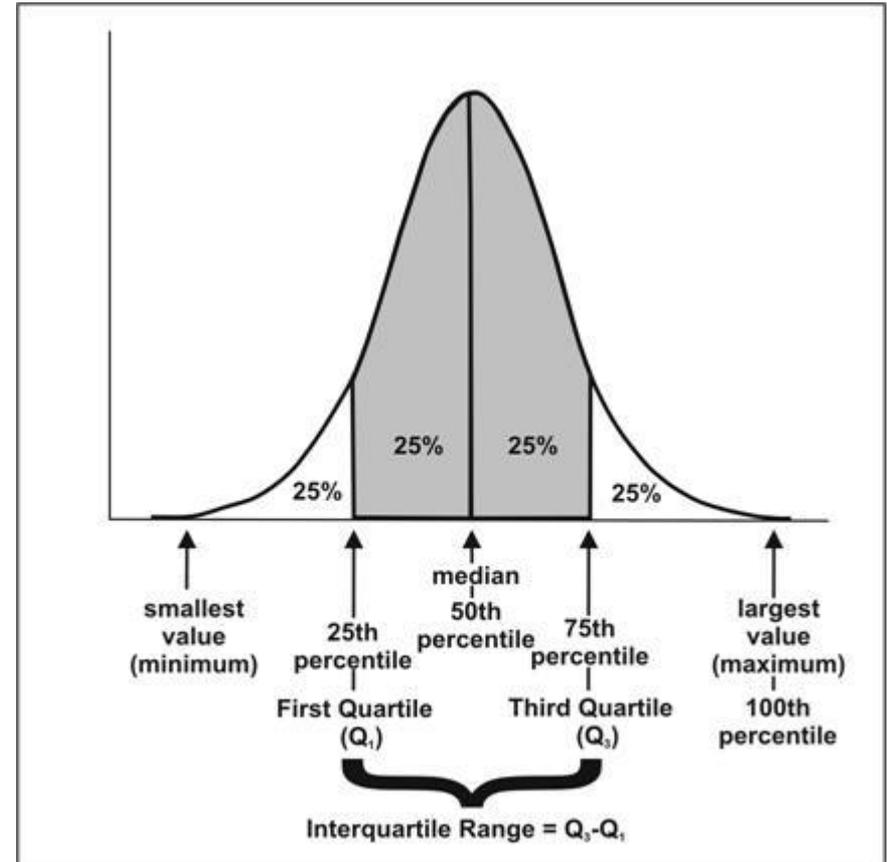
- ❖ Intercompany agreements are in principle leading.
- ❖ Are adjustment clauses included e.g. Force Majeure.
- ❖ Applicable law → Law of reasonableness and fairness?
- ❖ Would third parties share the loss?
- ❖ A two-sided approach is required considering the actual conduct of parties involved and the impacts on profitability.
- ❖ If required, conclude new agreements or make temporary adjustments.

**TP POLICIES
SHOULD
FOLLOW
THE
BUSINESS!**

CALCULATING POTENTIAL PRICING ADJUSTMENTS



- ❖ Generally, the median is applied
- ❖ The lower quartile may also be applicable in case of a crisis
- ❖ Or even a nil margin?
- ❖ Which benchmark to use?
- ❖ Multi-year averaging



EXAMPLE: MULTI-YEAR AVERAGING (SINGAPORE)



<u>Actual results</u>	Financial year 2018 S\$	Financial year 2019 S\$	Financial year 2020 S\$	Financial year 2018 to 2020 S\$	
Sales to third party customers	25,000,000	30,000,000	15,000,000	70,000,000	A
Less: Purchases from parent company	(17,000,000)	(20,000,000)	(12,000,000)	(49,000,000)	
Gross Profit	8,000,000	10,000,000	3,000,000	21,000,000	
Less: Operating expenses	(7,000,000)	(8,500,000)	(4,000,000)	(19,500,000)	
Actual operating profit	1,000,000	1,500,000	-1,000,000	1,500,000	B
Actual operating margin (B/A)	4.00%	5.00%	(6.67%)	2.14%	

As Company A's actual operating margin for financial year 2018 to 2020 is lower than the nearest edge of the arm's length range of 3%, Company A makes year-end adjustments to the actual results of financial year 2020 by reducing the purchases from parent company by S\$600,000 (i.e. S\$49,000,000 – S\$48,400,000). There will be a corresponding reduction in the parent company's accounts for the sales to Company A.

<u>Arm's length result</u>	Financial year 2018 to 2020 S\$	
Sales to third party customers	70,000,000	X
Less: Purchases from parent company	(48,400,000)	
Gross profit	21,600,000	
Less: Operating expenses	(19,500,000)	
Arm's length operating profit	2,100,000	Y
Arm's length operating margin (Y/X)	3.00%	

THE IMPACT OF GOVERNMENT SUBSIDIES (1)



Par 1.132 OECD-TPG: 1.132 There are some circumstances in which a taxpayer will consider that an arm's length price must be adjusted to account for government interventions such as price controls (even price cuts), interest rate controls, controls over payments for services or management fees, controls over the payment of royalties, **subsidies** to particular sectors, exchange control, anti-dumping duties, or exchange rate policy. As a general rule, these government interventions **should be treated as conditions of the market in the particular country, and in the ordinary course they should be taken into account in evaluating the taxpayer's transfer price in that market.** The question then presented is whether in light of these conditions the transactions undertaken by the controlled parties are consistent with transactions between independent enterprises.

THE IMPACT OF GOVERNMENT SUBSIDIES (2)



- ❖ What is the impact on the cost base?
- ❖ Example
 - Cost base: 100
 - TNMM / Cost plus margin: 5%
 - Government wage cost subsidy: 50

Scenarios	Scenario 1	Scenario 2	Scenario 3
Intercompany Transaction	105	52,5	55
Profit	55	2,5	5

- ❖ Both scenario 2 and 3 would be in line with the functions, risks and assets profile of the company, but some countries take the position that their subsidies are exported in this way and therefore argue that scenario 1 is correct.

FINANCIAL TRANSACTIONS



Due to the pandemic, MNEs' cash flow and liquidity are substantially affected. This will have an impact on intercompany financial transactions:

- ❖ Re-examine the financing structure to ensure that the entities are properly capitalised.
- ❖ Consider conversion of debt into equity or re-financing.
- ❖ Amend the pricing policies of intra-group financing arrangements as the crisis may influence the credit rating of the group or the group members.
- ❖ The potential absence of covenants that are often in place with third party banks does not mean that related parties should not act if significant changes in ratio's (e.g., debt-to-equity and interest-coverage) occur.
- ❖ Benchmarking with third party loans that took place pre Covid-19 is a serious comparability defect and not accepted by tax authorities. Corporate bonds are a suitable alternative since their value changes on a day-to-day basis.

DOCUMENTATION OF POSITIONS



- ❖ Supplement usual MF and LC documentation with a Covid-19 Times TP-file (“C-file”) should be prepared which includes MNE and company specific timelines and tracks relevant changes to the business of the MNE and who takes control over risk.



- Due to the pandemic, the tax audit investigations will likely increase in the future due to the loss of revenue and the increased debt for the government.



- MNEs are advised to document thoroughly the extraordinary decisions since they can be used as a robust defense for any potential challenges in the future.



- MNEs are suggested to collect as much information as they can concerning the uncontrolled transactions behaviour in the same industry. Further, it may be considered to introduce force majeure clauses in intercompany agreements.

DOCUMENTATION
SUBSTANTIATION
DOCUMENTATION
SUBSTANTIATION

ABOUT TAXAND

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SPEAKER PROFILE



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Marc Alms is a Managing Director with Alvarez & Marsal Taxand in New York. He focuses on the integration of transfer pricing policies following a merger or other business restructuring event, which may include global transfer pricing planning and policy development relating to the development and exploitation of intellectual property rights.

With more than 20 years of experience assisting both public and privately held clients, Mr. Alms led engagements in planning and documentation of transfer pricing policies; in obtaining advance pricing agreements; and in assisting with competent authority for multinational corporations across a broad range of industries. Mr. Alms has assisted clients with the valuation of intellectual property rights for tax purposes, the establishment of cost sharing arrangements, and the defending of such policies before the IRS and other revenue authorities.

Marc's background includes leading teams in the evaluation of intercompany transactions to determine whether they meet applicable U.S. and foreign transfer pricing regulations, including the latest OECD BEPS guidelines.

SPEAKER PROFILE



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Hendrik Blankenstein joined Tax Partner AG in 2016 and leads its transfer pricing team.

From 1989 to 1995, Hendrik was an international tax consultant at Big 4 firms in both the US and The Netherlands. From 1996 to 2004 he worked as an in-house international tax and transfer pricing counsel at Nestlé's headquarter in Switzerland and from 2005 to 2015 as a partner in an international transfer pricing consultancy firm.

Hendrik provides transfer pricing advice to Swiss and foreign multinational clients in a variety of industries with a focus on the design of transfer pricing strategies, business process analysis, BEPS risks review, audit risk assessment and management, Advance Pricing Agreements and Mutual Agreement Procedures.

SPEAKER PROFILE



Jens Brodbeck

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Jens Brodbeck is an Executive at ENSafrica in the Tax department. He specialises in corporate international tax, with a specific focus on transfer pricing, inbound investments and cross-border structuring. He has been involved in transfer pricing since the introduction of the South African transfer pricing rules in 1995, assisting international and South African multinationals with their transfer pricing needs. He has substantial experience in the areas of transfer pricing advisory (including the performance of detailed value chain analyses and economic analyses), transfer pricing documentation, as well as transfer pricing risk management and dispute resolution (in South Africa, as well as in a number of African jurisdictions). In particular, Jens has negotiated a number of favourable settlements with the South African Revenue authorities on behalf of his clients.

He advises a range of international and South African multinationals on the tax, transfer pricing and exchange control consequences of cross-border transactions involving intellectual property and other intangible assets.

Jens has held lectures regarding the transfer pricing component of the Advanced Tax Law LLM at the University of Cape Town and is member of the Board of Directors of Taxand.

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Jimmie is a partner with Taxand Netherlands and a core member of the global Taxand Energy service line and Transfer Pricing service line.

Jimmie specialises in the energy sector, covering aspects relating to oil & gas, suppliers & contractors, electricity, alternative resources and renewables. He advises on corporate tax issues and heads the Dutch Transfer Pricing practice, providing functional and economic analysis, profit allocation and advance pricing arrangements with the tax authorities. He also assists with domestic and international matters such as tax control frameworks, setting up and analysing new businesses and joint ventures, and optimising existing business structures.

He is a member of the Dutch Bar, the Dutch Associations of Tax Advisors, and the International Fiscal Association. He is also a representative for the Dutch Association of Suppliers in the Oil & Gas Industry, and a member of the Dutch Association of Energy Law and Society of Petroleum Engineers.

Jimmie is a member of the Amsterdam Bar.