



Potential impact of COVID-19 on your current transfer pricing model: Is action required?

Introduction

First of all, we hope you and your families are staying safe and healthy during these challenging times. The impact of the COVID-19 outbreak has certainly been profound. We have all needed to implement drastic measures in order to remain in good health. These measures have also affected the current global economic environment and future economic consequences are still uncertain.

As a result, a wide variety of industries are facing severe consequences for their businesses. These consequences include a reduction in customer demand, disrupted supply chains, decreased liquidity, curtailed operations, and significant changes in how business is being conducted (e.g. working from home and virtual meetings).

While we realise businesses affected by the COVID-19 outbreak are currently implementing contingency plans to guarantee the continuation of their operational activities, we should not forget that effectively coordinating your transfer pricing policy during these critical times can unlock value. In fact, not acting could result in adverse tax consequences.

Especially now, a well-coordinated transfer pricing policy will provide opportunities for managing the liquidity within your corporate group and ensure any of the group entities' performed functions, assumed risks and used assets are remunerated properly, while taking the current economic situation into account.

We have therefore compiled the following list of action points for you to consider.

Action points

• Adjusting transfer prices

Some corporate groups are - both voluntarily and involuntarily - scaling back or shutting down their operations in several jurisdictions, while other companies might benefit from the COVID-19 outbreak. Government lockdowns and unprecedented economic circumstances have forced companies to rethink, and potentially restructure, their intercompany arrangements. The corporate groups' transfer prices need to be in line with the commercially driven changes which the international supply chain has been subjected to. You also need to ensure the transfer pricing policy reflects any re-allocation of functions, assets and risks across the group as a result of any such commercially driven restructuring.

• Reassessing financial transactions

The economic downturn we are currently facing may require multinational enterprises to reassess their existing intercompany financing arrangements and come up with appropriate liquidity management structures. A stronger need for intragroup funding and parent or cross guarantees on third party lending can be expected for group entities operating in the affected regions.

Cash pooling structures can also be set up to manage liquidity within the corporate group and support group entities in the affected regions. The transfer pricing aspects related to these financial transactions will need to be carefully assessed.

- **Allocation of losses**

While some industries will be negatively hit by the COVID-19 outbreak, other industries will benefit. Companies in industries negatively affected by the COVID-19 outbreak will inevitably face severe losses. Associated enterprises, like independent enterprises, can sustain genuine losses due to unfavourable economic conditions, inefficiencies, or other legitimate business reasons. The COVID-19 outbreak can certainly be seen as an unfavourable economic condition. However, that alone does not justify the legitimacy of group entities' loss-making positions. To substantiate your position, how will be dealt with the same, or similar conditions within third party relationships will be key.

- **(Re)valuation of intangibles**

The intangibles which could change the arm's length payments related to them could also be affected. For example, given the current economic circumstances, it may be appropriate to temporarily put royalty and licensing payments on hold. These payments are often based on turnover which may have plunged due to the current economic downturn, or – in the worst case scenario – which is no longer being generated.

- **Impact on Advanced Pricing Agreements**

The COVID-19 outbreak could potentially have an impact on future Advanced Pricing Agreements (APA) negotiations, as the pandemic's long-term effects on the global economy are still uncertain and independent comparable companies could possibly also be in loss-making positions over the next few years. The COVID-19 outbreak may affect current APAs too, as the current economic environment which many companies are facing now is likely to be different to the economic environment these companies were facing at the time of filing the APA request.

Getting in touch with the tax authorities could provide some insight into the position adopted by tax authorities in relation to APAs currently in place and

which have been subject to fundamentally changed circumstances and how to react in order to mitigate adverse effects as much as possible.

- **Benchmarking and performing future economic analyses**

Taking the consequences of COVID-19 into account when performing a benchmark might not be a matter which will be acted upon at short notice, but is nevertheless of importance for future transfer pricing analyses. The effects of the economic downturn we are currently facing has diverse consequences across markets, industries and even individual companies. This reduces the chances of finding appropriate comparable transactions and conducting reliable future benchmark analyses. These differences – which will substantially affect the comparison - will need to be adjusted, allowing for the comparison to become more reasonable and reliable.

In conclusion

The matters included in this flyer concern some critical transfer pricing issues which corporate groups should now be analysing. There may be other transfer pricing related issues which should also be taken into account, given the current circumstances, depending on the individual characteristics of the industry your business operates in. In this respect, special consideration should be given to the 'relief' programmes put in place in certain jurisdictions (i.e. extension of deadlines to prepare documentation, etc.)

Our team of experts would be happy to advise you regarding the implementation of transfer pricing related actions. Please feel free to contact your Baker Tilly advisor, or contact our Transfer Pricing Desk via transferpricing@bakertilly.nl and they will contact you as soon as possible.

Disclaimer

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