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COVID-19: Impacts and challenges in transfer pricing

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The world is facing a global health crisis with the Coronavirus pandemic. Travel restrictions and activity bans have been successively issued by governments all around the world. These anti-epidemic policies are **paralyzing the global economic activity** and will lead to **future pressure on tax authorities** to increase tax revenues through audits to finance these measures. Multinational enterprises ("MNEs") are being considerably affected, with, for example, the inevitable closure of production site and distribution facilities, having consequences in tax matters and particularly in **transfer pricing (TP)**.

These economic disruptions raise many burning questions: **How to adapt MNE's supply chain? Are the TP policies ensuring an operational profit for distributors or service providers viable? How should the losses and exceptional or restructuring costs be allocated between the MNE's entities? What are the impacts of the pandemic on intra-group funding?**

In further publications, we will examine these fundamentals issues in greater depth.

❖ Review and adjustment of current Transfer Pricing policies

Number of MNEs implement a transfer pricing model based on one principal entity (**the entrepreneur**) performing entrepreneurial functions and one or more entities performing the so-called "**routine**" functions. These entities are required to generate a fixed level of margin.

In consideration of the exceptional economic circumstances related to the Covid-19 pandemic, should we consider a modification in **the allocation of profits and losses**? Should the profitability of the routine entities be affected by the overall losses incurred by the group as a direct result of this crisis? The following key issues can consequently be raised:

- Should a **reasonable level of profits be guaranteed** to entities with limited risks in all circumstances?
- Which group entities have **to bear the losses**?
- Which entities must bear the consequences of a **sub-activity**?
- Should costs be revised when the TP methods applied are based on **budgeted costs**?
- Are **new economic analyses** necessary? More specifically, are reviews of the functional profile and comparable used before the crisis to support intra-group transactions necessary?
- How should MNEs **document** and analyze the transfer pricing impacts arising from the new circumstances?
- Is it possible to **forecast future losses** arising from this crisis and reduce accordingly the profits allocated by the TP method?

❖ Supply Chain disruption and business restructuring

When activities have ceased, have been significantly reduced or **relocated**, it results in a reorganization of the supply chain and thus of **commercial or financial relations** between MNE's entities. As a result, **a business restructuring** can be characterized.

- Can we consider the existence of intangible transfers (customers, etc.) when a group entity ceases production or sale of products due to activity restrictions and another group entity performs this production or sales?
- How should **restructuring costs** be allocated among the entities?

❖ Impacts on intra-group financing

Intra-group financing needs, including guarantee supports for loans granting by third parties, will be important. Over and above the necessary qualification **of financial transactions as debt or capital** according to their characteristics and purposes (cf. [OECD Guidance on Financial Transactions of 11 February 2020]), but also according to the borrower's repayment capacities and **options realistically available** to the borrower as well as to the lender, the current situation will require particular attention with regard to:

- The granting of intra-group loans;
- The management of cash flow needs;
- The set-up of a Cash-Pool;
- The need to issue intra-group guarantees.

❖ Advance Pricing Agreements (APAs)

MNEs may be in the process of negotiating an APA or are currently applying such an agreement.

These rulings may become unenforceable because previous transfer pricing models are no longer adequate to the **exceptional circumstances unforeseen** at the time of the APA negotiation.

- Have the concluded APAs foresee a crisis like the current crisis among the citric hypotheses?
- How to adapt the terms and conditions of an APA to **exceptional circumstances** due to economic difficulties arising from Covid-19 crisis?

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