



International Tax ADVISORY ■

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How to Price in a Pandemic: New OECD Guidance on Transfer Pricing Challenges Caused by COVID-19

On December 18, 2020, the Organisation for Economic Co-operation and Development (OECD) published [new guidance](#) (Guidance) on the transfer pricing challenges caused by the COVID-19 pandemic. The Guidance, which reflects the consensus of the 137 Inclusive Framework members, focuses on how the arm's length principle and the 2017 OECD Transfer Pricing Guidelines (OECD TPG) apply to certain issues arising from the COVID-19 pandemic. As emphasized in both the Guidance and comments made by OECD officials, the Guidance is not meant to encourage taxpayers to depart from the arm's length principle as set out in the OECD TPG.

The impact of the COVID-19 pandemic varies widely and depends on multiple factors including industry and geography. The demand for some products and services has collapsed and supply chains have been disrupted, while at the same time, certain industries are facing unprecedented growth. Thus, there can be no one-size-fits-all approach to transfer pricing analyses in light of the pandemic. As the Guidance emphasizes, each taxpayer must closely consider its facts and circumstances and should contemporaneously document how, and to what extent, it has been impacted by the pandemic.

The Guidance, prepared by the OECD with input from business groups, covers four areas: (1) comparability analysis; (2) losses and the allocation of COVID-19 specific costs; (3) government assistance programs; and (4) advance pricing agreements (APAs).

Comparability Analysis

The economic impacts of the COVID-19 pandemic create unique and varying challenges for performing comparability analysis, which may require taxpayers and tax administrations to consider practical approaches that can be adopted to address information deficiencies. The Guidance provides several examples of practical approaches that taxpayers and tax administrations may use, including:

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- Allow the use of reasonable commercial judgment supplemented by contemporaneous information to set a reasonable estimate of the arm's length price – multinational enterprise (MNE) groups should document the best available market evidence currently available (e.g., internal comparables, external comparables, or other relevant evidence of the economic impact of the COVID-19 pandemic).
- Where feasible, apply an arm's length outcome testing approach that may incorporate information that becomes available after the close of the taxable year to determine arm's length conditions.
- Test pricing using more than one transfer pricing method.
- Isolate testing periods and price setting for the pandemic period from the pre- and post-pandemic periods.
- Allow for the inclusion of price adjustment mechanisms in controlled transactions.

The Guidance suggests that another approach that taxpayers should consider in setting transfer prices is to compare budgeted or forecast financial results to those actually achieved. Such a comparison may allow taxpayers to approximate the effects of the pandemic on revenues and paint a picture of the financial outcomes that taxpayers within a controlled transaction would have achieved "but for" the impact of the pandemic. This approach reflects a recurring theme in addressing pandemic transfer pricing issues: [taxpayers should take steps now](#) to identify and preserve relevant internal and external data and information to support their transfer pricing.

The Guidance indicates that certain comparability analyses routinely exclude loss-making comparables and that it may be appropriate to include loss-making comparables when performing a comparability analysis for FY 2020. Setting aside questions of whether excluding loss-making comparables without further analysis is appropriate, the Guidance provides that "loss-making comparables that satisfy the comparability criteria in a particular case should not be rejected on the sole basis that they suffer losses in periods affected by the COVID-19 pandemic."

The Guidance also emphasizes that taxpayers should not rely on a comparability analysis that is solely based on financial information from the 2008–2009 global financial crisis. Despite the superficial similarities between the two crises, the Guidance states that such a comparability analysis would not be appropriate "given the unique and unprecedented nature of the COVID-19 pandemic and its effect on economic conditions, as well as the variability of the impact by business sector of the 2008–2009 crisis." Based on our experience, meaningful guidance can be gleaned from the 2008–2009 crisis and applied, with appropriate modifications, to the COVID-19 pandemic and follow-on effects (e.g., post-pandemic economic conditions).

Losses and the Allocation of COVID-19 Specific Costs

As a result of the COVID-19 pandemic, many MNE groups have incurred losses due to various factors, including decreased demand, supply chain disruptions, and exceptional operating costs. The Guidance seeks to address common questions about such pandemic-related losses, and certain issues may be relevant to tax planning involving, for example, the [base erosion and anti-abuse tax](#) and the Coronavirus Aid, Relief, and Economic Security Act.

When considering the risks assumed by a party to a controlled transaction, the Guidance suggests that tax administrations should “carefully consider the commercial rationale for any purported change in the risks assumed by a party before and after the outbreak of COVID-19.” According to the Guidance, the allocation of exceptional pandemic-related costs should reflect the parties’ risk allocation: “If a cost directly relates to a particular risk, then the party assuming that risk would typically bear the costs associated with that risk.” The Guidance notes that certain operating costs may not be viewed as exceptional or nonrecurring in circumstances where the costs relate to long-term or permanent changes in the operations of the business.

It may be necessary to consider specifically how exceptional costs arising from COVID-19 should be taken into account when performing a comparability analysis. The Guidance states that “exceptional costs should generally be excluded from the net profit indicator except when those costs relate to the controlled transaction as accurately delineated,” and the exclusion of exceptional costs should be done consistently at the level of the tested party and the comparables.

During exceptional economic circumstances, like the COVID-19 pandemic, the Guidance explains that independent parties may seek to renegotiate certain terms in their existing agreements or may not hold each other to the strict terms of their contracts, and associated parties should consider this behavior in determining whether to modify their intercompany agreements and commercial relationships. The Guidance appears to place a high level of scrutiny on such analyses: “in the absence of clear evidence that independent parties in comparable circumstances would have revised their existing agreements or commercial relations, the modification of existing intercompany arrangements and/or the commercial relationships of associated parties is not consistent with the arm’s length principle.” Any such modifications should be “treated with caution,” according to the Guidance, and should be “well-supported by documentation outlining how the modification is in line with the arm’s length principle.” In cases where taxpayers invoke [contractual force majeure clauses](#) as the basis for modifying their intercompany agreements or arrangements, the Guidance recommends a similar level of scrutiny. The heightened scrutiny reflected in the use of terms such as “clear evidence” and “treated with caution” in the Guidance should put taxpayers on notice to perform appropriate due diligence and preserve relevant evidence to support modifications to intercompany agreements.

Government Assistance Programs

Government assistance programs designed to address the COVID-19 pandemic may have transfer pricing implications, whether the government assistance is provided to a member of an MNE group directly or made available to independent parties within the market in which an MNE group operates.

Government assistance programs may constitute economically relevant features of tested transactions. The Guidance explains that a government assistance program would likely be economically relevant in circumstances where the receipt of government assistance may have a direct impact on the controlled transaction and comparable transactions between independent parties (e.g., a wage subsidy, a government debt guarantee, or short-term liquidity support). The Guidance does not discuss the potential scope of what may be viewed as government assistance (e.g., a government contract that absorbs fixed costs). If government assistance is determined to be an economically relevant characteristic, the Guidance suggests that information related to such assistance should be included as a part of the documentation to support the transfer pricing analysis.

Whether the receipt of government assistance affects the price of controlled transactions depends on the economically relevant characteristics of the transaction, and such characteristics are identified by accurately delineating the controlled transaction and performing a comparability analysis. Therefore, the Guidance explains that “it would be contrary to the arm’s length principle to assume that the mere receipt of government assistance would affect the price of the accurately delineated controlled transaction, without performing a careful comparability analysis.”

The receipt of government assistance may affect the comparability analysis, and, therefore, it could be necessary to take the receipt of government assistance into account when reviewing potential comparables. The Guidance notes that there may be challenges related to understanding the nature of government assistance received by potential comparables due to the variety of government assistance programs available in different jurisdictions and the difficulties that taxpayers and tax administrations may face in obtaining the relevant information.

APAs

The COVID-19 pandemic has led to material changes in economic conditions that could not have been anticipated by taxpayers or tax administrations when the terms of many APAs covering years affected by COVID-19 were agreed. Therefore, the Guidance explains that it is important to determine to what extent, if any, the change in economic conditions affects the application of existing APAs. Additionally, taxpayers that are currently negotiating APAs that apply to years affected by COVID-19 may be uncertain about the most reliable approach to account for the pandemic.

The Guidance states that “existing APAs and their terms should be respected, maintained and upheld, unless a condition leading to the cancellation or revision of the APA (e.g. breach of critical assumptions) has occurred.” Determining whether a breach has occurred should be done on a case-by-case basis, taking into account the circumstances of the taxpayer and the commercial environment. According to the Guidance, a mere change in business results during the period affected by COVID-19 would generally not result in a breach of a critical assumption.

As discussed in the Guidance, taxpayers should notify the relevant tax administrations as soon as possible if any of the critical assumptions of existing APAs are breached. Taxpayers and tax administrations should then consider the terms of the APA, any agreement between relevant tax administrations regarding how to deal with the failure, and any applicable domestic law or procedural provisions. A breach of critical assumption in an APA could have three potential outcomes: revision, cancellation, or revocation. The Guidance notes that revocation would not likely be an appropriate outcome solely due to the impacts of the COVID-19 pandemic.

If a taxpayer believes that the terms of its APA are no longer appropriate, the Guidance explains that the taxpayer should not attempt to breach critical assumptions deliberately or fail to comply with the terms or conditions of the APA. Rather, if a taxpayer has concerns, it should discuss those concerns with the relevant tax administration.

In the case of APAs currently under negotiation that apply to FY 2020, the Guidance encourages taxpayers and tax administrations to “adopt a flexible and collaborative approach to determine how to take into account the current economic conditions.” The Guidance suggests that parties could consider agreeing to a

separate short-period APA covering only the period affected by the COVID-19 pandemic. Alternatively, if the parties would rather enter into an APA covering years affected and unaffected by the COVID-19 pandemic, the APA could include a condition that the relevant impacts of the COVID-19 pandemic will be analyzed and reported annually once they are known and any necessary retrospective amendments to the APA could be made accordingly. Another option for an APA covering years affected and unaffected by the COVID-19 pandemic might entail extending the term of the APA to mitigate the short-term impacts of the pandemic or a cumulative term test could be used.

Concluding Remarks

The OECD should be commended for preparing and releasing the Guidance, reflecting a consensus view of the Inclusive Framework members, before the end of the calendar year. Although the Guidance understandably leaves many questions unanswered, it reiterates the central role of the arm's length standard and provides guideposts for taxpayers and tax administrations as they analyze how the COVID-19 pandemic is affecting intercompany pricing (positively and negatively). Companies should carefully evaluate the Guidance as they implement practical and defensible solutions going forward.

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Alston & Bird has formed a multidisciplinary [response and relief team](#) to advise clients on the business and legal implications of the coronavirus (COVID-19). You can [view all our work](#) on the coronavirus across industries and [subscribe](#) to our future webinars and advisories.

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Our tax team also joined our Intellectual Property Group for a webinar to discuss "[Tax and Litigation Implications of Intellectual Property Ownership & Licensing](#)."

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