

Amicus Alert: OECD Guidance on Transfer Pricing Implications of Covid-19 – Part I: Comparability Analysis

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Introduction

On December 18, 2020 the Organization for Economic Cooperation and Development (OECD) released its guidance on the transfer pricing implications of COVID-19 pandemic. This guidance seeks to address practical challenges in transfer pricing analysis that may emerge due to the effects of the COVID-19 pandemic.

The guidance notes that the existing OECD Transfer Pricing Guidelines 2017 (TP Guidelines) have been sufficient and effective in the vast majority of cases and should continue to be relied upon when performing a transfer pricing analysis. It focuses on how the arm's length principle and the TP Guidelines apply to situations that may arise in the context of the COVID-19 pandemic, rather than on developing specialized guidance beyond what is already addressed in the existing Guidelines.

Issues covered

The guidance provides commentary and illustrations on the practical application of the arm's-length principle for four main areas. The Guidance is divided into these four sections to highlight challenges multinational enterprises (MNE) may come across while complying with transfer pricing regulations due to COVID-19:

- Comparability analysis;
- Losses and the allocation of COVID-19 specific costs;
- Government assistance programs; and
- Advance pricing agreements (APAs)

The four priority issues identified should be considered together within the framework of the TP Guidelines in order to find a reasonable estimate of an arm's length outcome. In this article we will be discussing the first section which provides possible approaches that should be kept in mind while undertaking a comparability analysis.

Transfer pricing guidance on comparability analysis

The unprecedented changes in the global markets following the COVID-19 outbreak brought about unique challenges for undertaking a comparability analysis. It had a significant impact on the pricing of some transactions between independent enterprises, therefore, reducing the reliability of historical data for performing a comparability analysis.

Sources of contemporaneous information that can be considered for performance of comparability analysis

The OECD suggests the use of any form of publicly available information that may be useful for assessing arm's length conditions during the pandemic. Among these, the main sources of information that may help in performing a comparability analysis are:

- analysis of change in sales volumes specifically due to Covid-19;
- change in capacity utilization (due to government shutdowns, supply chain disruptions);
- information relative to incremental or exceptional costs (hikes in cost of logistics and raw materials);
- details regarding government assistance and intervention;

- macroeconomic information like country specific GDP data or industry indicators;
- statistical methods for variance analysis (response of corporate profits in an industry to GDP movements);
- comparison of internal budget data with actual results; and
- third party behavior observed during FY 2020 or during previous recessionary periods.

Use of budgeted financial information to support the setting of ALP

The guidance suggests the **use of budgeted financial information** in order to approximate the effects of the pandemic on the company's profitability. The financial outcomes that taxpayers would have achieved within a controlled transaction 'but for' the impact of COVID-19 may provide useful information, particularly when assessing the financial impacts of COVID-19 and determining, in light of contractual terms and risk assumption of the parties, the resulting impact on inter-company prices.

While using their budgeted financial information, the MNEs should perform a detailed profit and loss assessment showing pandemic induced changes in revenue and expenses, change in allocation of costs and the details regarding government assistance to approximate their effects while supporting the setting of arm's length prices.

Practical approaches to address information deficiencies

The guidance suggests the **use of statistical methods such as variance analysis** to enhance a comparability analysis that otherwise would be constrained by the information deficiencies created because of the Covid-19 crisis. Variance analysis is used to predict the extent to which a certain variable will vary with reference to other variables under certain specific conditions (e.g., the response of corporate profits in certain industries to GDP movements).

Furthermore, the Guidance considers that tax administrations that otherwise would use the price-setting approach (ex-ante) can **allow for an outcome-testing approach (ex-post)**, where possible, to take into account information that becomes available after the close of the taxable year.

Additionally, the guidance also suggests the **use of more than one transfer pricing methods** to reach at the arm's length price in situations where it proves to be more effective. The use of more than one transfer pricing method, although not required under the OECD TP Guidelines, may be useful to corroborate the arm's-length nature of the intercompany pricing.

Period of data to be used to evaluate ALP to support a comparability analysis

The principles outlined in the OECD TP Guidelines regarding the **use of multiple year data and averages** remain applicable. In ordinary circumstances, the use of multiple year data and multiple year averages for comparability analyses may have certain advantages. It can be used as a means to mitigate the impact of accounting differences, appropriately measure the effects on profitability thereby increasing reliability of the comparison, etc. The use of combined periods, that include both years that are impacted by the pandemic and years that are not impacted, may improve reliability.

Furthermore, it states that the use of data from previous crises like the 2008 depression for performing a comparability analysis is not recommended because of the unique and unprecedented nature of the COVID-19 pandemic.

Guidance With Regard to Reviewing comparables

As per the guidance, in cases where taxpayers roll forward their existing set of comparables, a review in the context of the Covid-19 induced deviation may be necessary to validate their continued comparability, and revisions should be made to the comparables set if required.

While addressing the use of loss making comparables, the guidance notes that there is no overriding rule on the inclusion or exclusion of loss making comparables in the OECD TP Guidelines. The Guidance follows the TP Guidelines and states 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.

Concluding Remarks

The guidance outlines several practical approaches to deal with the difficulties that may arise while performing a comparability analysis. These will be helpful to MNEs as they seek to navigate the challenges in transfer pricing analysis during the affected periods. Accordingly, affected businesses should perform comparability analysis after gathering contemporaneous data and detailing the impact of the Covid-19 crisis.

Stay tuned for our next editions on Parts II-IV of OECD Guidance on Transfer Pricing Impact of Pandemic

II - Losses and the allocation of COVID-19 specific costs

III - Government assistance programs

IV - Advance pricing agreements (APAs)

ABOUT AMICUS

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The Firm focuses on providing efficient, effective, solution-oriented advice and representation based on specialist knowledge and experience. Amicus' boutique tax practice has been consistently been ranked as a leading practice by Legal 500, Asia Law and World Tax (ITR) and Transfer Pricing.





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