



COVID-19: Transfer Pricing considerations

Webinar held on 28 April 2020

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COVID-19 & TP

Introduction



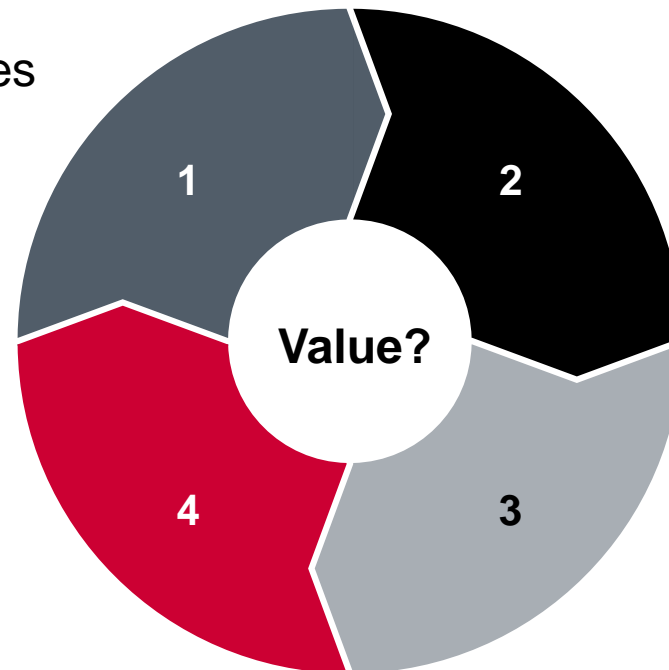
COVID-19: Impact for majority of groups

1) Supply chain

- » Price volatility & obsolescence
- » Reduced capacity & downtimes
- » Reduced demand
- » Rerouting of supply chain

4) Structural: the new normal?

- » Supply chain, financial, people: business models?
- » Impact on value chain, intangibles, enterprise value and shareholder value?



2) Financial

- » Reduced cash-flow
- » Adverse payment conditions
- » Increased liquidity needs
- » Secure short/long term financing

3) People

- » Staff reductions
- » Remote working
- » Changed roles & responsibilities
- » Crisis management

COVID-19: Business responses

NOW



LOOKING FURTHER

- » Managing crisis / keeping business afloat
- » Consolidated losses / significantly impacted (operating) results in 2020 (and further on)?
- » Preparing for new post-crisis realities / (temporary) changed supply chains
- » Expected increase tax authority scrutiny (compared to post-financial crisis)



Our comprehensive Covid-19 response framework

» Flow of 3 questions of scope of intervention:

- A** {
- 1. Can results outside the conventional arm's length range clearly be supported by existing division of accountabilities and responsibilities?**
 - contractual vs. actual conduct (functional analysis)
 - other comparability factors
 - 2. Can a deviation from the conventional arm's length range/policy be supported by explaining the exceptionality of the situation?**
 - point of view of the group on the whole and shareholder view
 - perspectives of the separate entities concerned: 'ORAs'
- B** {
- 3. When above not feasible, aren't there still opportunities to manage profit allocation/liquidity from transactional perspective?**

» 4 overarching questions:

- C** {
- 4. Does the solution represent a business restructuring?**
 - 5. Won't temporary solutions become a two-edged sword?**
 - 6. After-crisis dispute resolution?**
 - 7. When is it time to start acting?**

Agenda

TP perspectives
on managing profit
and liquidity issues:

A

Holistic

B

Transactional

C

Overarching

Our comprehensive Covid-19 response framework:

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4. **Does the solution represent a business restructuring?**
5. **Won't temporary solutions become a two-edged sword?**
6. **After-crisis dispute resolution?**
7. **When is it time to start acting?**

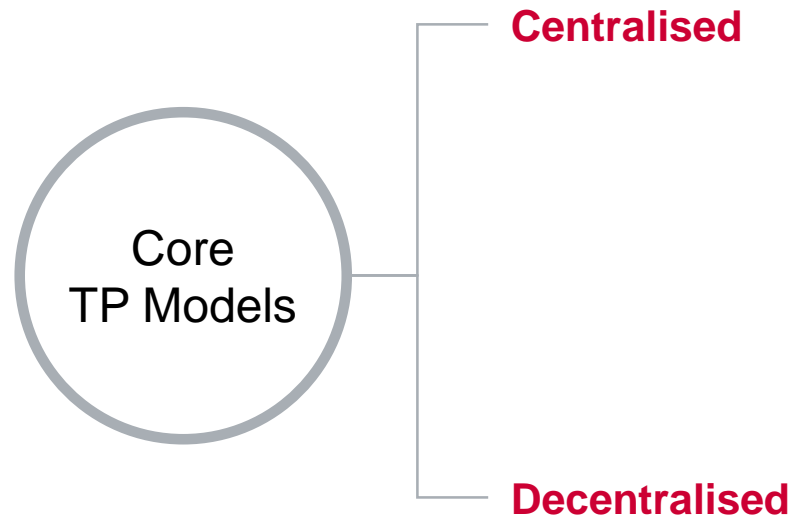
A

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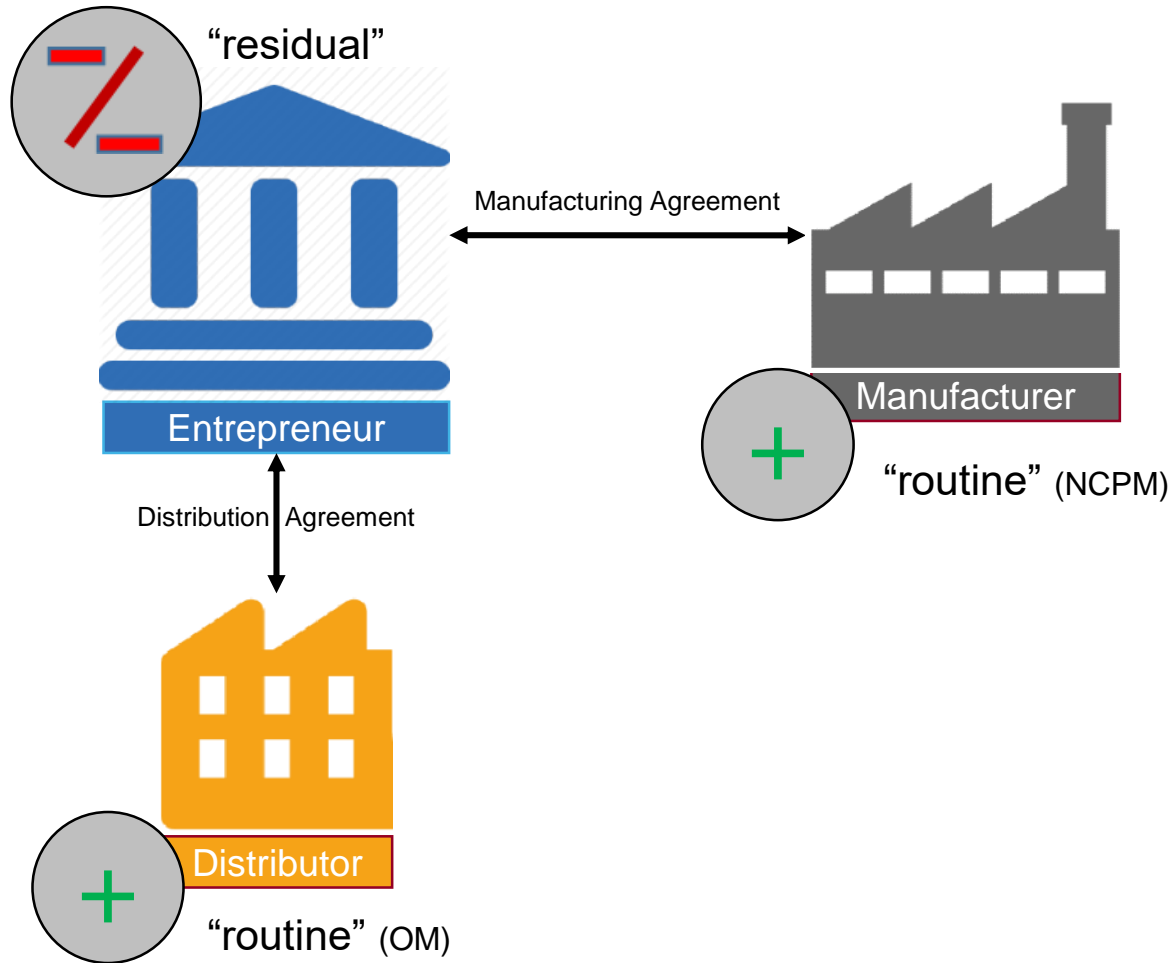
Holistic
transfer pricing considerations

Impact on TP Models



- » Full risk Entrepreneur earns “residual profits or losses”
 - » Limited risk/routine entities earn (stable) “routine profits”
 - » Single-sided method (TNMM)
-
- » Multiple Full-risk Entrepreneurs
 - » Managing significant risk and owning unique (intangible) assets
 - » Multi-sided method (Profit-split method)

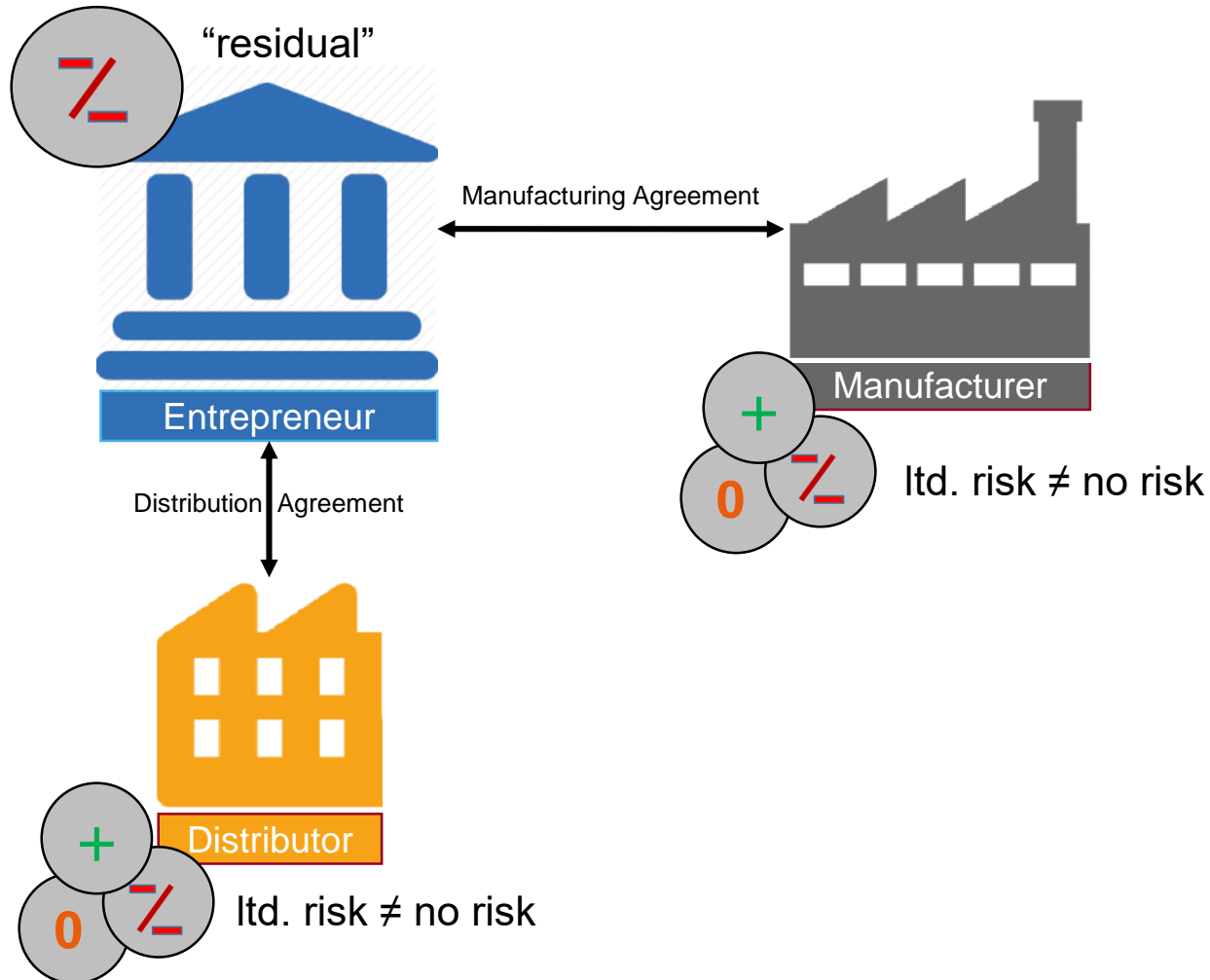
Centralised TP model: As-is



Continue on Autopilot ?

- » (Low risk/routine) Distributor / Manufacturer continue to earn (median) "routine" profits
 - › E.g. 3% Operating Margin
 - › E.g. 8% Net Cost Plus Mark-up
- » Tax cash-out for Manufacturer / Distributor
- » Entrepreneur incurs "residual" loss
 - › Often no carry back and /or carry forward restrictions in Entrepreneur jurisdictions

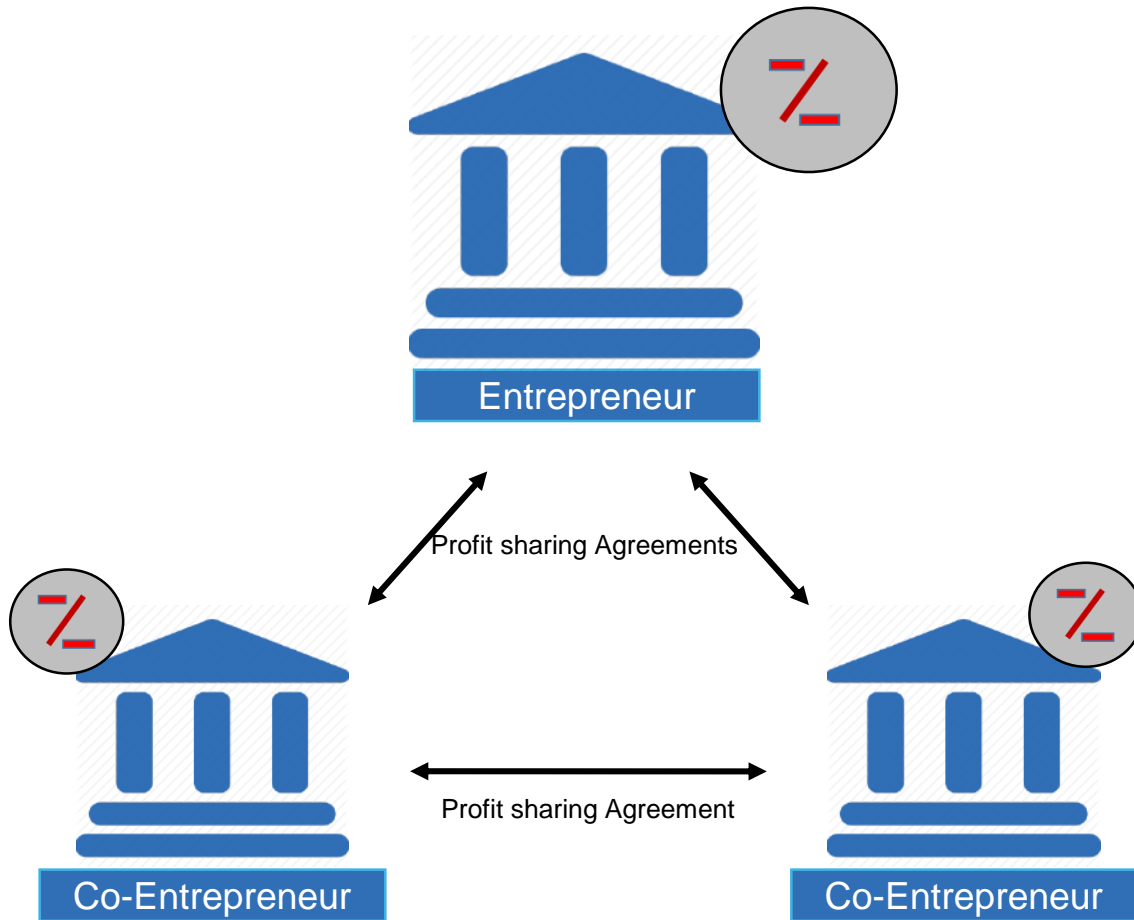
Centralised TP model: Potential interventions



Amend I/C pricing (temporarily)

- » Lower quartile?
- » 0% margin (break-even)?
- » Cover variable expenses?
- » Specific risk-return attribution?
- » 'Excess' loss absorption?
- » Sharing of negative synergies?
- » Comparables review?
- » **Resulting in a smaller profit, break-even position, or even (small) loss**

Decentralised TP model



Review RPS Agreements:

- » Loss split: symmetric <> asymmetric?
 - › Specific risk-return attribution?
 - › Sharing of negative synergies?
- » Allocate losses to beneficial jurisdictions?
 - › Allocation of 'uncontrollable' risk?

Live from the commentary box



» Autopilot/status quo?
vs. hard bargain?
vs. equitable ORA?

» Extent of lowered
profits (losses)
for routine entities?

B

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**Transactional
transfer pricing considerations**

Operational TP opportunities

	PROFIT ALLOCATION	LIQUIDITY
» Extend intercompany trade payment/inco terms?		✓
» Remunerate crisis management team”?	✓	✓
» Fee/Rent waivers/deferrals	✗	✓
» Execute inventory repurchases?	✓	✓
» Performance guarantees?	✓	✓
» Drive through restructuring (business restructuring, share deals, asset deals) with Covid-19 discount/premium?	✓	✓

Financial transactions TP opportunities

	PROFIT ALLOCATION	LIQUIDITY
» Introduce/extend intragroup factoring/payment factory?		
» Review cash pooling arrangements (credit limits)?		
» New loans/credit facilities, including shareholder loans (to execute implicit support)?		
» Debt/Interest deferrals/waivers in view of reduced EBITDA?		
» Interco interest rate swaps (on floaters) / cross-currency swaps?		
» When captive, use captive?		
» Drive through restructuring (loan unwinding/ refinancing) with Covid-19 discount/premium?		

Live from the commentary box



- » Real life examples helpful/needed?
- » Scrutiny (exceptional) financial transactions?

C

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**Overarching
transfer pricing considerations**

Business restructuring?

DOES A CHANGE TO MY
TP POLICIES IMPLY A
**BUSINESS
RESTRUCTURING?**

- » **‘Business Restructuring’** (OECD TP Guidelines, IX, par. 9.1)
 - › “*The cross-border reorganisation of the commercial or financial relations between associated enterprises, including the termination or substantial renegotiation of existing arrangements*”
 - ➔ Compensation for transfer of something of value (tangibles, intangibles – in respect to their broad TP definition – or ongoing concern?)
 - ➔ Indemnification for detriments suffered?

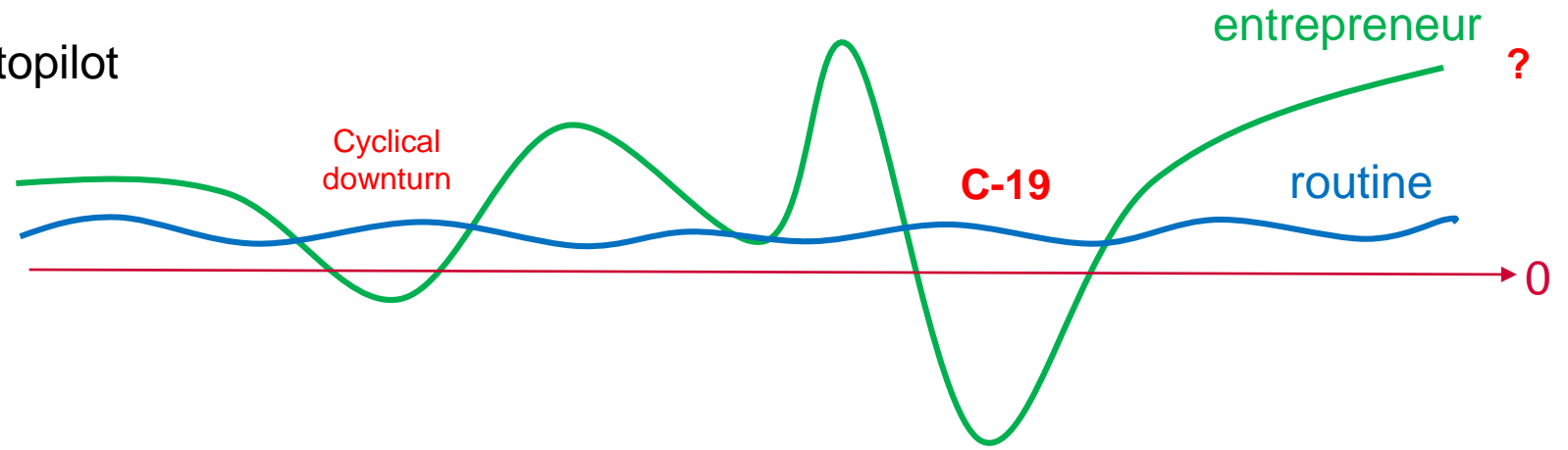
- » **ORA and valuation/pricing opportunities?**
 - › Covid-19 might be the trigger and/or provide for commercial rationale (best Option Realistically Available) to enter into a business restructuring now?
 - › Value of “something of value” transferred / economic damage better manageable?
 - **Value:** cash flow from existing assets, value added by growth assets (reinvestments), riskiness of cash flow outlooks, reaching steady state growth (and potential roadblocks)
 - **Pricing:** add liquidity and trading ease, mood and momentum, group think and incremental information, including perspectives of actual parties concerned)
 - › Quid, hard-to-value-intangibles (‘HTVI’)?



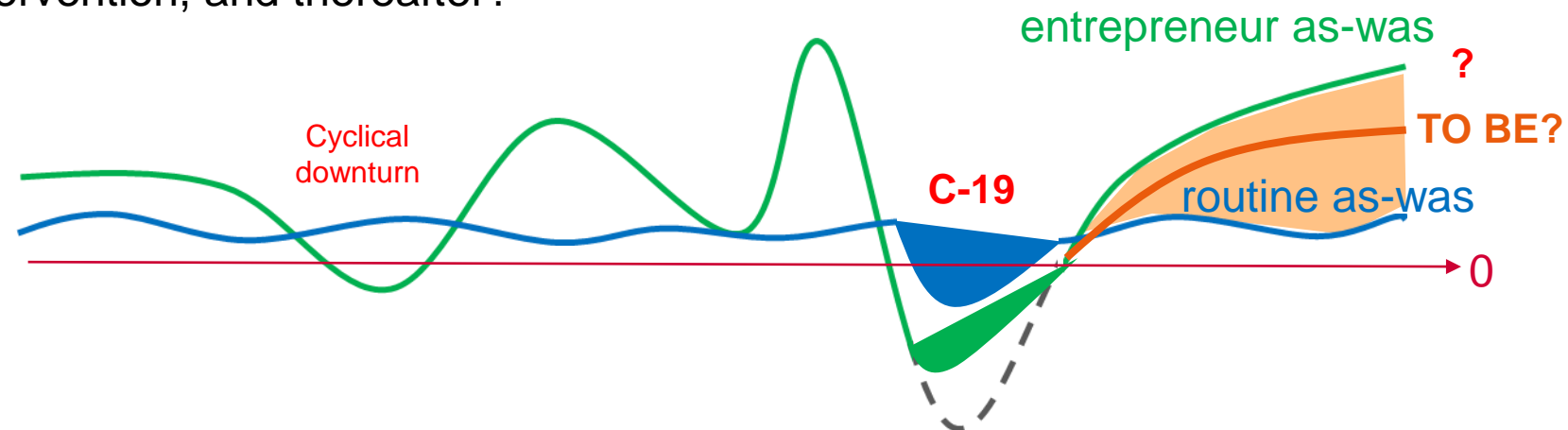
2-edged sword?

WHEN I NOW INTRODUCE
A LOWER THAN
CONVENTIONAL PROFIT
LEVEL BECAUSE OF THE
CRISIS,
DO I NEED TO CONSIDER
A PREMIUM PROFIT
LEVEL ONCE THIS IS
BEYOND US?

» Autopilot



» Intervention, and thereafter?



How to defend?

WHAT ARE THE KEY
ASPECTS IN
**DEFENDING TP
INTERVENTION?**

GENERAL

» **Contracts: Amend/Addendums**

- › Recitals are key: Scenery – Force Majeure – Options Realistically Available

» **Documentation:**

- › Statutory TP documentation requirements → **penalty protection** is key!
 - Consider past, present and future – even when timing is variable!
- › Additional recommended documentation / in-field evidence:
 - Real life examples of interventions → repository
 - Gather audit trail:
 - Internal notes of (joint) decision taking – sign off ORAs by local management
 - Run financial stress-tests / impact on enterprise value: normalized <> distress, including specific risk materialization valuations

How to defend?

WHAT ARE THE KEY ASPECTS IN DEFENDING TP INTERVENTION?

WHAT IF PRICE ADJUSTMENT IS CHALLENGED?

» Litigate

- › Fair changes of success (safe for abusive situations) but:
 - “litigation contamination”; and
 - blocked access to MAP / Arbitration (in most EU member states)

or

» MAP/Arbitration

- › DTT / MLI
- › EU Arbitration Convention
- › EU Dispute Resolution Directive

	MAP	Arbitration	Mandatory Binding Arbitration
› DTT / MLI	✔	?	✘
› EU Arbitration Convention	✔	✔	✘
› EU Dispute Resolution Directive	✔	✔	✔

How to defend?

WHAT ARE THE KEY ASPECTS IN DEFENDING TP INTERVENTION?

WHAT IF PRICE ADJUSTMENT IS CHALLENGED?

EU PERSPECTIVE TAKEAWAYS

- » Within EU free choice of instrument
 - › Multilateral (EU) vs. Bilateral (MLI) solution
 - › Timing procedure?
 - › **Effective outcome: No double taxation within EU?**
 - ✔ **Based on EU Directive / Arbitration Convention**
 - **Safe for ‘abusive situations’**
- » Penalty protection is key:
 - » States can only deny access to the dispute resolution procedure in case of “fraud, willful default and gross negligence” (art. 16.6 EU Directive)
 - » Same rule applies under the Arbitration Convention (art. 8.1.) – “serious penalty-criterion” (cf. unilateral declarations to the Convention)

Timing?

WHEN TO START
CONSIDERING
ACTION?

- » The time to (prepare for) taking action is **NOW**
 - » Evidence for effective date of (juridical) acts
 - » Ex-ante vs ex-post transfer pricing policies
- » **Continuous monitoring** is highly recommended
 - » Exit crisis strategy to be planned for: back-to-normal? <> a new normal?

Live from the commentary box



- » Risk management perspectives?
- » Final ideas or recommendations?

**Closing
thoughts**



Useful links

COVID-19:

- » <https://wts.com/global/insights/covid19>
- » <https://atlas.tax/en/news/covid-19>
- » <https://www.tiberghien.com/en/news/covid-19>
- » <https://www.oecd.org/coronavirus/en/>
- » <https://www.who.int/emergencies/diseases/novel-coronavirus-2019>

» **Other**

- » <https://wts.com/global/experts/tp-team>
- » <http://www.taeconomics.com/>

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We are going through an unprecedented situation which is hitting our private and professional lives extremely hard. Let's stay strong, safe and shoulder to shoulder with friends, family, colleagues & clients.





Your local contact persons

 **Your contact persons**

Locally rooted - Globally connected



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