

Exceptional Business & Economic Disruption

Transfer Pricing Issues & Impacts

March 2020



Intercompany pricing issues can have a magnified impact on a business's financial and tax position during times of severe economic stress and disruption. TP should therefore be an important consideration for most businesses in these times.

A combination of reduced liquidity, employment, investment and consumer demand have lowered market valuations. The impact and effectiveness of governmental intervention -- in the time of lowered interest rates, injection of liquidity and fiscal stimulus -- remains to be seen.

This economic downturn will certainly affect TP - but how?

In analyzing all of these implications, holistic, real-time modeling is essential to inform tax, finance and business decisions. We have tools that can take existing data -- both client-specific and external -- to model the directional impact of the economic downturn and identify the main areas of concerns and risks as well as potential opportunities.

Common transfer pricing ("TP") issues that many organizations are facing during times of economic and business disruption

Liquidity and Financial Transactions

- ☐ Liquidity in markets;
- ☐ Liquidity intragroup;
- ☐ Valuation and pricing;
- ☐ Term loan agreement renegotiations;
- ☐ New guarantees; and
- ☐ Local thin capitalization impacts.



Extraordinary expenses

- ☐ Allocation of extraordinary expenses;
- ☐ TP provisions; and
- ☐ Extraordinary expense justification.



Stranded workforce

- ☐ Stranded employees;
- ☐ Value chain analysis alteration;
- ☐ PE and personal income tax exposures; and
- ☐ PE profit attribution analysis.



Operations and supply chain

- ☐ Shift in functions, risks and assets;
- ☐ Changes in TP outcomes; and
- ☐ Changes in intercompany agreements.



Business restructurings

- ☐ Business disruption;
- ☐ Movement of functions, assets, risks and profit potential; and
- ☐ Certain functions to be replaced by technology.



APMA/Controversy

- ☐ Postponed litigation;
- ☐ Increased audits; and
- ☐ Considerations on APAs and MAPs.



Comparability analysis

- ☐ Recent business, tested party and transaction stresses;
- ☐ Impacts on comparability; and
- ☐ Comparability adjustments.



TP policies

- ☐ Potential losses;
- ☐ Strain in "limited risk" models; and
- ☐ Tax authority challenges if losses are borne by routine entities.



BEPS

- ☐ Heightened uncertainty from the OECD's ongoing project;
- ☐ Timeliness of new tax rules and associated burdens in present environment under question; and
- ☐ New policy questions raised by present environment.



Trade

- ☐ Cash needs;
- ☐ Supply chain transparency for disruption identification; and
- ☐ Trade corollary impact for TP modifications.



Exceptional Business & Economic Disruption:

TP Issues & Impacts (I)



Liquidity & Financial Transactions

ISSUE

Many businesses will have to evaluate sources of liquidity externally and revisit internal sources and needs. This will give rise to considerations around intercompany cash pools and financing. Issues to address could involve changes in terms, impact on economics due to existing cash pool pricing policies, FX impacts (losses and hedges), guarantees on third party debt, as well as issues around loan valuation and pricing.

IMPACT

- ☐ External financial (debt capacity and market liquidity) and performance guarantee considerations
- ☐ Ratings and pricing impacts for current/new loans
- ☐ Distribution/allocation of FX losses
- ☐ Tactical transactional considerations (duration and term)
- ☐ Valuation of notes/receivables and refinancing considerations,
- ☐ Impact of changes in terms of significant modification and impact on debt characterizations and deductibility

KEY QUESTIONS

- ☐ How is your company accessing funding - drawing revolvers, new debt, changing terms, dividend freeze?
- ☐ How are your external lending terms and pricing being impacted?
- ☐ Which affiliates are requiring liquidity for short term needs and are they cash pool participants?
- ☐ Which affiliates are requiring longer term credit?
- ☐ Have you considered the TP impacts of 'call-on' parental guarantees by third party lenders?
- ☐ Have you considered the disruption implications on previously issued performance or financial guarantees?
- ☐ Have you considered the impact of negative yields - including in short term US treasuries - and their impact on existing short-term funding needs and policies?
- ☐ Are you changing internal or external payment terms or covenants?
- ☐ Are FX positions hedged centrally for the group? If yes, have there been material realized or unrealized FX losses or gains on your FX positions and hedges and what are the policies on allocating those losses to affiliates?



Extraordinary expenses

ISSUE

Examples of extraordinary expenses generated during times of business disruption may include employee health and wellness expenses; additional maintenance, obsolescence of inventory, and termination of contracts. Need to assess the treatment of extraordinary expenses.

IMPACT

- ☐ Beneficiaries of extraordinary expenses;
- ☐ TP provisions; and
- ☐ Extraordinary nature justification.

KEY QUESTIONS

- ☐ Have you identified the "beneficiaries" of extraordinary expenses?
- ☐ Have you considered booking TP provisions?
- ☐ Is a comprehensive analysis in place that can be used to defend the extraordinary nature of the expenses?
- ☐ Have you analyzed the arm's length nature of intercompany transactions after the exclusion of extraordinary expenses?
- ☐ Have you considered exploring arguments that the U.S. should economically bear the foreign loss burden under a "protect and promote" theory?

Exceptional Business & Economic Disruption:

TP Issues & Impacts (II)



Stranded workforce

ISSUE

Many businesses will restructure their business operations to ensure they adapt to the new economic circumstances in the time of business disruption and thereafter. This may result in the movement of local profit earning potential.

IMPACT

- ☐ Business disruption;
- ☐ Movement of functions, assets, risks and profit potential; and
- ☐ Role of people vs. technology.

KEY QUESTIONS

- ☐ Have you considered TP issues such as arm's length compensation for any restructuring (i.e., exit charges)?
- ☐ Have you considered variations in TP outcomes for local subsidiaries?
- ☐ Have you considered how the restructuring may impact the substance requirements?
- ☐ Have you considered the need to build an ad-hoc business restructuring chapter in your TP documentation?



Operations and supply chain

ISSUE

Transactions involving the flow of goods, services and financing in particular, may be disrupted or economically altered. Functions, risks and assets assumed by parties may significantly shift during the business disruption or thereafter.

IMPACT

- ☐ Shift in functions, risks and assets;
- ☐ Changes in TP outcomes; and
- ☐ Changes in intercompany agreements.

KEY QUESTIONS

- ☐ Have you assessed the impact on the group's operations, supply chain and functional analysis?
- ☐ Have you assessed whether a TP adjustment is warranted on account of the "special circumstances" at play?
- ☐ Have you assessed the impact from any new intercompany transactions on Masterfile and Local File TP documentation?
- ☐ Have you formulated a plan to proactively approach tax authorities to apply for tax rulings to achieve certainty?



Business restructurings

ISSUE

Many businesses will restructure their business operations to ensure they adapt to the new economic circumstances in the time of business disruption and thereafter. This may result in the movement of local profit earning potential.

IMPACT

- ☐ Business disruption;
- ☐ Movement of functions, assets, risks and profit potential; and
- ☐ Role of people vs. technology.

KEY QUESTIONS

- ☐ Have you considered TP issues such as arm's length compensation for any restructuring (i.e., exit charges)?
- ☐ Have you considered variations in TP outcomes for local subsidiaries?
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Exceptional Business & Economic Disruption:

TP Issues & Impacts (III)



APMA/Controversy

ISSUE

Many tax authorities will be temporarily closing offices, extending certain deadlines (if legally possible), and considering how the economic shock impacts existing and in process APAs.

IMPACT

- ☐ Potential cancellation or adjustment of existing APAs;
- ☐ Potential enforcement of APA targets despite the economic shock
- ☐ Need to consider revised benchmarking strategies, shorter or longer APA terms, etc., for in process APAs to address the economic disruption

KEY QUESTIONS

- ☐ Does your organization have existing APAs that lock in transfer pricing targets?
- ☐ Does your organization have any pending APAs that are under consideration by the tax authorities?
- ☐ Is your organization preparing to file with any tax authority any APA or MAP submissions or treaty notifications? Is there a deadline?
- ☐ Is your organization prepared for increasing TP audits?



Comparability analysis

ISSUE

Businesses may face issues such as the devaluation of some currencies, increase in accounts receivables and payables and changes in levels of inventory. Benchmarking analyses performed for FY20 for TP purposes need to be revisited.

IMPACT

- ☐ Recent business, tested party and transaction stresses;
- ☐ Impacts on comparability; and
- ☐ Comparability adjustments.

KEY QUESTIONS

- ☐ Have you considered revising existing benchmarking analyses?
- ☐ Have you considered building-up special factor analyses in your TP Documentation to reflect specific market circumstances?
- ☐ Have you established an approach to justify deviations (if any) from established group TP policies?



TP policies

ISSUE

Many businesses will incur losses, which may generate a strain in limited risk models. Such companies will likely be challenged by tax authorities if they suffer from sudden losses or low profitability if they have historically been part of limited risk models.

IMPACT

- ☐ Potential losses;
- ☐ Strain in limited risk models; and
- ☐ Tax authority challenges if losses are borne by routine entities.

KEY QUESTIONS

- ☐ Do you have a system in place to monitor and implement the necessary year-end TP compensating adjustments?
- ☐ Have you considered the implications that the year-end TP adjustments may have on customs, VAT and withholding taxes?
- ☐ Have you revisited the group's TP policy to potentially share risk / losses, revise the operating model?
- ☐ Have you revisited your valuations to accurately capture the revised arm's length value of IP?
- ☐ Will year end adjustments be required?

Exceptional Business & Economic Disruption:

TP Issues & Impacts (IV)



BEPS

ISSUE

As the OECD continues to implement the digitalization project, new issues around its impact on how economic conditions should be reflected in Pillar I and Pillar II should be considered.

IMPACT

- ☐ The timing of implementation of new rules can impact how the recovery from this downturn affects your organization;
- ☐ The design of new rules (e.g., Amount B and its application in downturns) can exacerbate the effect of economic shocks on companies; and
- ☐ Different business models (based on different intercompany structures) may be more or less resilient against such effects.

KEY QUESTIONS

- ☐ Has your modeling taken into account implementation of the BEPS 2.0 unified approach?
- ☐ Have you evaluated how an economic downturn changes the impact of Pillar I and II on your organization?
- ☐ How do alternative operating models and intercompany structures influence such impacts?



TRADE

ISSUE

1. Companies **need cash** and duty drawback refund programs are quickly becoming a priority;
2. Companies **need data** for supply chain transparency; and
3. Companies are **changing TP policies** (e.g., tangible pricing) and should also model trade impact.

IMPACT

- ☐ Cash needs;
- ☐ Supply chain transparency for disruption identification; and
- ☐ Trade corollary impact for TP modifications.

KEY QUESTIONS

- ☐ Have you increased cash projections through a duty drawback program or considered enhancing your existing duty drawback program?
- ☐ Have you considered the impact of shifts in imports and exports related to changes to your US supply chain?
(Note: Company's Custom's ACE data can show product origin where a Company's ERP / Logistics system do not).
- ☐ Are you making changes to your TP policies that may impact your trade policies?

TP Team

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