



# PwC's Transfer Pricing Services: Helping Your Business Deal With COVID-19

As of 26 February 2020, the Corona Virus Disease 2019 (COVID-19), which was first discovered in Wuhan, has been diagnosed with over 77,000 people in China, and has posed great challenges to domestic business. With China being the world's second largest economy and major manufacturing centre, the impact of the epidemic on Chinese enterprises is bound to pass through value chains and affect global economy.

Faced with the sudden epidemic, governments at all levels have successively issued a series of anti-epidemic policies. Companies in China and even group headquarters have also actively taken crisis response measures to reduce the impact of the epidemic on subsidiaries operating in China and on the group as a whole. However, for most companies, short-term performance fluctuations are inevitable. During this special period, we believe that many financial and tax managers of multinational enterprises are considering whether the group's existing related-party transaction arrangements and profit distribution mechanisms can still be effective to control transfer pricing risks.

PwC hopes to take this opportunity to share some of our observations in order to help your management effectively manage the potential transfer pricing risk and improve the "immunity" in financial and tax management when facing the challenges caused by the epidemic.

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## Business impacts and challenges faced by companies

- Companies fail to comply with their contractual obligations due to interruptions in business operations
- Due to the knock-on reaction to the downstream customers, the business's capacity is still lower than expected after resuming production
- Supply chains are cut off and materials need to be sourced from overseas related parties
- Immigration control measures affect scheduled travel, meetings and other activities, and service transaction arrangements between related parties need to be adjusted
- There is an increased risk of transfer pricing arrangements being challenged by tax authorities going forward for companies with long-term losses or low or varying profits that suffer from further performance changes due to the epidemic
- Tightened cash flow and a need for additional financing through intra-group as well as external financing transactions
- The complexity and uncertainty of the tax treatments regarding the medical equipment needed during the epidemic, which may be imported from overseas related parties either for donations or for the company's own use
- Possible impact of the APA schemes in respect of application or implementation
- Companies affected by the epidemic need to seek and understand government subsidy policies to hedge their own losses
- The epidemic may increase the need for production bases outside China and companies may consider reallocating capacity within the group, thus accelerate the restructuring of supply chains and creating related-party transactions within the group



## Our Suggestions

### Timely plan for transfer pricing during the epidemic

- Review related-party transaction agreements or contracts, focusing on the confirmation of risk and liability attribution under extraordinary conditions, determine whether related-party transaction arrangements match the function and risk profile of each related party in the value chain, and whether the existing transfer pricing policy is reasonable.
- Implement transfer pricing adjustment in relation to transactions that have potential transfer pricing risks, and discuss the specific action plans (such as timely price adjustments or arrangements with transfer pricing year-end adjustments, etc.).
- Formulate reasonable pricing mechanisms and implementation plans in response to supply chain adjustments or new types of related party transactions (such as transactions of tangible assets, service transactions or medical equipment donations) derived in relation to the epidemic.
- Define transfer pricing arrangements related to financial transactions, and provide an operational basis for intra-group financing transactions to relieve cash flow burden.
- Take advantage of digital tools to improve transfer pricing risk management and analysis systems, make sure the management can track the implementation of the group's transfer pricing policy in a timely manner and make proper adjustments as needed.
- Help the management to learn about the local government's anti-epidemic policies, communicate actively with governments to seek policy and regulation support to mitigate the impact resulting from the epidemic, such as policies in relation to tax exemption or deduction, extension of tax declaration, finance subsidies, guarantees of resuming production and financial credit support.

### Improve post-epidemic transfer pricing risk control and compliance

- Many enterprises may face remarkable changes in performance or even loss in 2020. In order to ensure the rationality of the group's transfer pricing policy, a quantitative analysis shall be conducted and recorded in the transfer pricing documentation :
  - Step 1: collect operational and financial data to identify the reasons for any changes in performance;
  - Step 2: based on a value chain analysis and functional analysis, determine the loss that should be borne by local entities, make quantitative analysis of the relevant impact, and pay attention to different account treatment (i.e. the accounting classification of expenses that may be incurred this time, such as production suspension costs, etc.) and possible differences of accounting treatments between the current year and future years;
  - Step 3: Record relevant analysis results in the company's transfer pricing documentation, including the compliance documentation, and submit them to the tax authorities if necessary, so that the tax authority may have a vivid understanding of the epidemic's impact on the company's operations.
- Pay attention to changes in related-party financing transactions. Enterprises whose ratio of related party debt investment to equity investment exceeds the standard ratio shall prepare special issue file on thin capitalization.
- In addition to compliance work, enterprises should actively seek for the proper communication channel on complex transfer pricing issues and other tax issues with governments (such as the Tax Bureau, Customs, Administration of Foreign Exchange, etc.) to get understanding. Effectively mitigate potential tax and business risks by means of Advance Pricing Arrangements and advance rulings.

### How PwC can help

- **Transfer pricing planning**
- **Transfer pricing year-end adjustment solution**
- **Value chain analysis and transformation / global restructuring**
- **Transfer pricing risk assessment and data analytics platform**
- **Consultation on Advance Pricing Arrangements (APA)**
- **Transfer pricing controversy and dispute resolution**
- **Transfer pricing compliance**

The impact of the epidemic is still ongoing and it has brought great challenges to domestic businesses. However, everyone from the government to companies and individuals is trying to fight the epidemic. PwC China still takes a positive view of the future market and we are actively participating in the joint battle against the epidemic by helping you cope with tax risks and challenges, such as transfer pricing matters, in this very special period of time.

## Let's talk

For a deeper discussion of how this issue might affect your business, please contact PwC's Transfer Pricing Team:

With close to 3,000 tax professionals and around 200 tax partners in Hong Kong, Macao, Singapore, Taiwan and 22 cities in Mainland China, PwC's Tax and Business Service Team provides a full range of tax advisory and compliance services in the region.

Our dedicated transfer pricing professionals across Hong Kong and China have extensive experience and knowledge in helping clients to develop tax efficient structures to increase compliance with transfer pricing regulatory requirements, prepare for rapid audit responses, resolve disputes and decrease future adjustment exposure.

### Central

#### Shanghai

##### Spencer Chong

Partner  
+86 (21) 2323 2580  
spencer.chong@cn.pwc.com

##### Jeff Yuan

Asia Pacific Transfer Pricing Services  
Leader, Partner  
+86 (21) 2323 3495  
jeff.yuan@cn.pwc.com

##### Mei Gong

Partner  
+86 (21) 2323 3667  
mei.gong@cn.pwc.com

##### Paul Tang

Partner  
+86 (21) 2323 3756  
paul.tang@cn.pwc.com

##### Thinker Chen

Partner  
+86 (21) 2323 1329  
thinker.x.chen@cn.pwc.com

##### Silina Zhong

Partner  
+86 (21) 2323 3393  
silina.s.zhong@cn.pwc.com

##### John Bian

Partner  
+86 (21) 2323 3149  
john.bian@cn.pwc.com

##### Jessica Yin

Partner  
+86 (21) 2323 1108  
jessica.yin@cn.pwc.com

#### Suzhou

##### Henry Zhu

Partner  
+86 (512) 6273 1917  
henry.hp.zhu@cn.pwc.com

#### Chengdu

##### William Xu

Partner  
+86 (28) 6291 2018  
william.xu@cn.pwc.com

### Xian

##### Jackie Zhao

Partner  
+86 (29) 8469 2661  
jackie.zhao@cn.pwc.com

### North

#### Beijing

##### Qisheng Yu

Partner  
+86 (10) 6533 3117  
qisheng.yu@cn.pwc.com

##### Winnie Di

Partner  
+86 (10) 6533 2805  
winnie.di@cn.pwc.com

##### Thomas Han

Partner  
+86 (10) 6533 3230  
tao.han@cn.pwc.com

##### Feng Yang

Partner  
+86 (10) 6533 3042  
f.yang@cn.pwc.com

##### Jason Yan

Partner  
+86 (10) 6533 3638  
jason.m.yan@cn.pwc.com

##### Ying Yue

Partner  
+86 (10) 6533 3087  
ying.yue@cn.pwc.com

#### Dalian

##### Robin Zhang

Partner  
+86 (411) 8379 1698  
robin.zhang@cn.pwc.com

### South

#### Guangzhou

##### Kevin Tsoi

Partner  
+86 (20) 3819 2380  
kevin.lk.tsoi@cn.pwc.com

### Vincent Li

Partner  
+86 (20) 3819 2170  
vincent.li@cn.pwc.com

#### Shenzhen

##### Rhett Liu

Partner  
+86 (755) 8261 8366  
rhett.k.liu@cn.pwc.com

##### Marc Li

Partner  
+86 (755) 8261 8232  
marc.li@cn.pwc.com

#### Hong Kong

##### Cecilia Lee

Partner  
+852 2289 5690  
cecilia.sk.lee@hk.pwc.com

##### Phillip Mak

Partner  
+852 2289 3503  
phillip.mak@hk.pwc.com

##### Peter Brewin

Partner  
+852 2289 3650  
p.brewin@hk.pwc.com

##### Ali Tse

Partner  
+852 2289 3508  
ali.mh.tse@hk.pwc.com

##### Tiffany Wu

Partner  
+852 2289 3662  
tiffany.m.wu@hk.pwc.com

##### Wengee Poon

Partner  
+852 2289 5675  
wengee.w.poon@hk.pwc.com

##### Alex Xiang

Partner  
+852 2289 5817  
alex.xiang@cn.pwc.com