



# OECD Guidance on the transfer pricing implications of the Covid-19 pandemic

Mazars transfer pricing think tank

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# Introduction

**The Covid-19 pandemic has far-reaching consequences and will have serious implications on transfer pricing for many multinational enterprises. In December 2020, the OCDE released its Guidance in order to clarify and illustrate the practical application of the arm's length principle as articulated in the OECD Transfer Pricing Guidelines.**

Four priority issues were identified and are covered in the Guidance:

- comparability analysis;
- losses and the allocation of Covid-19 specific costs;
- government assistance programmes; and
- advance pricing agreements (“APAs”).

Following a worldwide internal think tank and the organization of a webinar, Mazars transfer pricing experts would like to share their view on the OECD publication through this report<sup>1</sup>.

1. OCDE (2020), « Guidance on the transfer pricing implications of the Covid-19 pandemic », OECD Policy Responses to Coronavirus (Covid-19), Éditions OCDE, Paris, <https://doi.org/10.1787/731a59b0-en>.



# Guidance on comparability analysis

## OECD Guidance §9:

“The unprecedented change in the economic environment [...] may require taxpayers and tax administrations to consider practical approaches that can be adopted to address information deficiencies, such as comparability adjustments. Such practical approaches regarding the performance of comparability analyses should be consistent with the transfer pricing policy of the taxpayer over time.”



## Mazars' view

For those companies heavily impacted by the Covid-19 crisis, comparable company searches performed in 2019 or before should be reviewed for continued comparability. Because 2020 financial data will generally only be available in commercial databases by the middle or end of 2021, this gap period poses a potential issue for transfer pricing analyses. Thus, to address information deficiencies, adjustments to comparable companies' financial data would be necessary. To this end, we suggest the following methodological approaches:

- Adjustment can be performed based upon the variation of the revenue and costs of the clients impacted negatively as well as positively by the Covid-19 pandemic.
- Macro economic analysis on GDP using European statistics OECD and Eurostat websites could service as a reliable source for adjustments to be applied. Nevertheless, it is recommended to apply it in light of the overall impact of Covid-19 on a particular industry, as according to our observation not all industry branches in the same region are affected by the pandemic in the same way. The different impact is observed also in relation to particular product segment in the same industry (e.g. food market on US territory).
- Additional TP adjustments based upon the 2020 financials of the comparable companies may be required in Q3 or Q4 2021.
- The selection of 3 years of financials for the comparable companies may have to be revisited.

**The analyses to be undertaken will increase the burden of the proof, the risks of TP assessments, the work to be done to prepare TP documentation as well as the cost of such documentation during and post Covid-19.**

# Guidance on comparability analysis

## OECD Guidance §15 & 16:

“Taxpayers are more likely to have current information on potential internal comparables, where these can be used to price related party transactions. In other instances, it may be more challenging to use contemporaneous uncontrolled transactions as part of a comparability analysis, notably in the application of the transactional net margin method (“TNMM”).”

## Mazars’ view

The OECD recognizes the difficulties taxpayers may face however does not provide with enough practical guidance on how to handle the comparability analysis, but rather asks tax authorities to be pragmatic in their appreciation of the approach of the taxpayers within their transfer pricing analyses. We believe authorities are not likely to be more flexible with MNEs during the Covid-19 pandemic or after.

Thus, extreme care must be taken in justifying the transfer pricing behavior in this pandemic period. More robust information regarding changes in the taxpayer's business operations, pricing policy and operating profitability should be properly captured and detailed in the TP documentation. This would also serve as a basis for defense in the event of a tax audit on transfer pricing.

The OECD gives preference to the application of CUP method. In practice, the application is possible in case of availability of the reliable internal data or public external data. However, several issues may arise:

- Tax authorities do not always accept the application of the method (if used, always with or as corroborative); and
- This method is difficult to apply and substantiate

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## OECD Guidance §17:

“A long term arrangement covering FY 2019 through FY 2022 may be in place, including an arm’s length price based on comparables contemporaneous with the negotiation of the arrangement, that insulates the tested party from risks that the tested party does not assume like those that play out during the pandemic.”

## Mazars’ view

Unlike the position of the OECD, consider that third parties are willing to renegotiate long term agreements. Indeed, from a transfer pricing standpoint, related parties have to act together as third parties would do and we are of the opinion that even in the frame of a long term agreement, if there is a distortion in the economic circumstances, two unrelated parties would renegotiate the term of the agreement.



# Guidance on comparability analysis

## OECD Guidance §27 & 28:

“It may be appropriate to have separate testing periods (and periods considered for price setting) for the duration of the pandemic or for the period when certain material effects of the pandemic were most evident. [...] In undertaking a benchmark analysis, care should be taken in verifying that comparable enterprises have faced similar restrictions or conditions.”

## Mazars' view

If divergent economic conditions during and post-pandemic period are evidenced, it may be appropriate to have separate testing periods for the duration of the pandemic and for the immediately following years, when certain material effects of the pandemic were most evident. However, the OECD publication does not provide a clear guidance on how to find and use the data required. From US perspective, we could suggest to look for quarterly data especially during 2020 which is available in 10Ks reports, however collection of similar financial information is extremely difficult, even impossible outside of the US.

Moreover, the Covid-19 has impacted differently each region, and within a region such as the EEU, the impact of Covid-19 has been different by country. Each country in the EEU had different strategies concerning lockdowns and quarantines. Thus, we consider that country by country analysis could produce more reliable results.

This geographical restriction could lead to a reduction of the number of comparable, thus in order to obtain reliable data, in the frame of the benchmarking analysis, it should be appropriate to relax comparability criteria. Moreover, the OECD expressly states that loss-making comparables may be included in the final set especially during the Covid-19 period.



# Guidance on losses and allocation of Covid-19 specific costs

## OECD Guidance §39:

“Therefore holds open the possibility that simple or low risk functions may incur losses in the short-run. In particular, when examining the specific facts and circumstances, the analysis should be informed by the accurate delineation of the transaction and the performance of a robust comparability analysis.”



## Mazars' view

All limited risk distributors potentially may record losses, a functional analysis will need to be updated in order to reflect the exact risks incurred by the limited risk entities during the Covid-19 pandemic. This situation can also be due to a change in the functional profile. To this end, it is important to note, that the tax authorities may examine whether the different allocation of the risks between the parties after Covid outbreak is a result of a business restructuring.

Therefore, new risk allocation must be supported by an analysis of all the facts and circumstances and to substantiate the position. At the same time, it could be necessary to analyze what realistic alternatives for action a routine entity would have on the market in order to determine the relevance of turning off and on TP methods during and post Covid-19 pandemic - e.g. if the contractual framework provides for a guaranteed profit to be earned by a routine enterprise, due to general economic developments such as short-time work, closures etc. it is unlikely to receive secure remuneration even in third-party relationships.

Thus, an update of a functional and risk analysis seems mandatory in order to justify the economic situation of the company. The main suggestion is to include within TP documentations a specific section for the period impacted by the Covid-19 including detailed industry analysis and description of the group's behavior and the one of the tested company during the period.



# Guidance on losses and allocation of Covid-19 specific costs

## OECD Guidance §42:

“The accurate delineation of the controlled transaction will determine whether the revision of intercompany agreements is consistent with the behavior of unrelated parties operating under comparable circumstances.”

## Mazars' view

The main situation in which independent parties would be in a position to renegotiate their contract is the case where significant changes in financial circumstances occurred in their contractual relationship. We could consider that an analysis of the economical circumstances of the contract should be sufficient, however, the taxpayers may also a need for a modification with internal CUP(s).

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## OECD Guidance §48 & 49:

“Allocation of operating or exceptional costs would follow risk assumption and how third parties would treat such costs. [...] Further, it should be noted that certain operating costs may not be viewed as exceptional or non-recurring in circumstances where the costs relate to long-term or permanent changes in the manner in which businesses operate.”

## Mazars' view

MNEs may face difficulties in the determination of normal costs of business, exceptional costs and exceptional ones that will permanently incur post Covid-19. However, this identification can allow the exclusion of the exceptional costs from the profit level indicator at the level of the tested party and comparable subject to local tax and accounting regulations.





# Guidance on government assistance programmes

## OECD Guidance §65:

“The terms and conditions of government assistance programmes related to Covid-19 need to be considered when determining the potential impact of these programmes on controlled transactions and when comparing their effects with those of other pre-existing assistance programmes.”

## OECD Guidance §74:

“The economically relevant characteristics of the accurately delineated controlled transaction will help in determining the potential effect of the receipt of government assistance on the pricing of the controlled transaction, if any.”

## Mazars' view

Generally speaking, the treatment of the government assistance in transfer pricing depends on the method applied. These assistance programmes have an impact within the SG&A, thus a transfer pricing policy based on costs. As example, wage subsidies have an impact for service providers, manufacturers and distributors comparability. Indeed, a transfer pricing policy based on a percentage of wages, government assistance should lead to a reduction of the amount rebilled. This conclusion is based on the actual treatment of R&D credit for which it is allowed to offset the credit and recharge the net cost. In the same manner, government debt guarantee might have an impact on intercompany loans analysis and especially in the standalone analysis.

Moreover, comparables might also benefit from government assistance programmes, their financial statements are impacted. The question at stake is how to take into account such aids in the financial statements of the comparables, all the more that governments did not provide the same types of assistance and did not applied the same.

It has to be noticed that some countries like Australia, Canada, New Zealand or Senegal, explicitly refused the possibility of deducting costs in the calculation of the transfer pricing. Thus, a case by case analysis would need to be performed. Thus, the treatment of government grants and assistances must be in line with the local tax and accounting rules and regulations.



# Advance pricing arrangements

## OECD Guidance §89:

“Some taxpayers may face challenges applying existing APAs under the economic conditions resulting from the Covid-19 pandemic. In those instances, taxpayers are encouraged to adopt a collaborative and transparent approach by raising these issues with the relevant tax administrations in a timely manner.”

## Mazars’ view

Taxpayers need to analyze if the current economic condition is or is not compliant with the existing APAs. Indeed, such agreements generally include critical assumptions regarding operational and economic conditions. The impact of the pandemic has had different consequences for companies, hence a case-by-case analysis of a potential breach of a critical assumption have to be performed. Once recognized, three potential consequences: revision, cancellation or revocation. In any event, the OECD recommends that competent authorities should be approached before making any adjustment or action that is not in line with the terms of the APA.

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## OECD Guidance §109:

“Where taxpayers and tax administrations are negotiating APAs that are intended to cover FY2020, all parties are encouraged to adopt a flexible and collaborative approach to determine how to take into account the current economic conditions.”

## Mazars’ view

Taxpayers need to analyze if the current economic condition is or is not compliant with the APAs under negotiation. A cautious approach can only be advised and taxpayers should, in any event, approach the competent authorities. The possible outcomes of such a discussion are the continuity of the procedure, the renegotiation of critical assumptions of APAs under negotiation, or the revocation of the APA applications.



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