Tax Alert

ISSUE 1 | **FEBRUARY 2021**

OECD Transfer Pricing Guidance on Implications of the COVID-19 Pandemic

A Singapore Perspective

The OECD has published guidance on the transfer pricing implications of the COVID-19 pandemic on 18 December 2020 (OECD Guidance). This Tax Alert provides our key observations on the new OECD Guidance as well as insights and practical considerations on how Singapore taxpayers could be affected.

The Inland Revenue Authority of Singapore (IRAS) has previously published answers to frequently asked questions on the transfer pricing issues relevant to COVID-19 on its website (IRAS FAQ), which briefly discussed the following:

— Supporting information to be included in the taxpayer's transfer pricing documentation
— Use of term testing for comparability analysis
— Proposed approach to existing and new APAs

In comparison, the OECD Guidance is more extensive.[1] However, as it represents a consensus document, most of the guidance refers to the industry practice or the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 (OECD TPG). The OECD Guidance focuses on four priority transfer pricing issues:

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

[1] For further details, please see Global KPMG report published on 23 December 2020.

Insights

In general, the OECD Guidance and IRAS FAQ refer to the various factors and supporting evidence which companies need to consider when reviewing or revising their transfer pricing arrangements during the period impacted by COVID-19. It is already clear that some of this information is only available in the moment when the decisions are made (decision making and support documents for crisis response, industry and economic snapshots) while others might not be available by the time when the financial accounts are due to be finalised (such as economic results of the comparable companies). Therefore, it is critical to consider the impact of COVID-19 now and collect the appropriate evidence to support the analysis.

We outline our key observations in the four areas discussed by the OECD TPG in the context of the IRAS FAQ as well as common issues we have observed over the past year.

01 Comparability Analysis

The OECD highlighted that one of the key consideration factors in the performance of comparability analysis is the geographical location of the comparable companies; owing to different levels of government intervention (lockdowns and halt of business operations, national response strategies to the pandemic impacting business operations, government assistance, etc.) and the general impact COVID-19 on economy and particular industries in different countries, resulting in different levels of marketplace, operational and financial risks.

This brings new challenges to the common approach of comparability analysis in Singapore, as well as the approach towards transfer pricing compliance and comparability analysis in YA 2021. Given significant change in the economic circumstances, simple roll forward of previous benchmarking set is likely to be an inadequate approach for YA 2021.

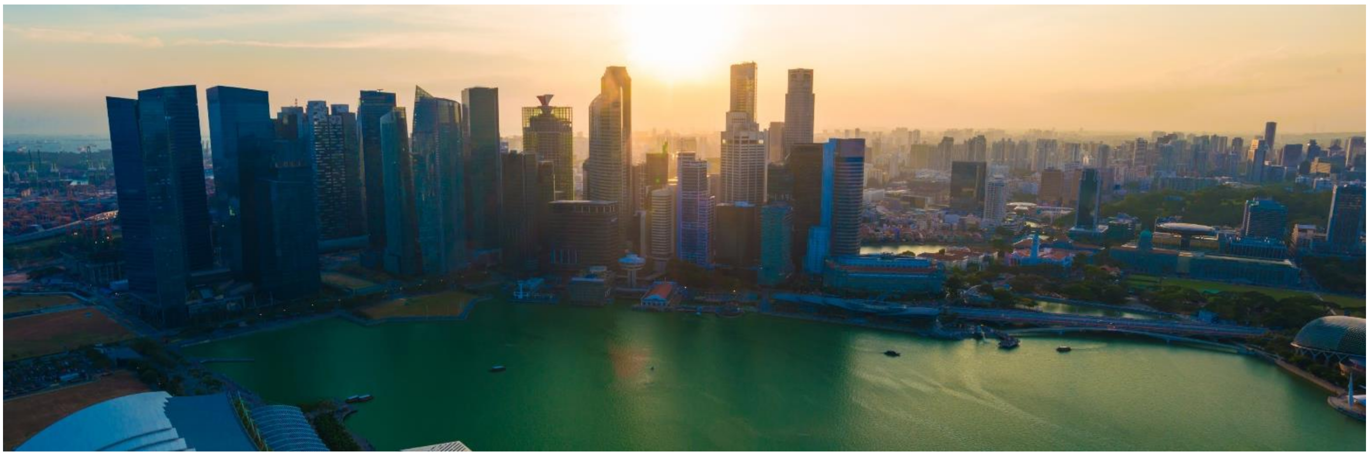
When finding comparable companies to analyse the financial results after the start of COVID-19, the companies should start reflecting on the measures taken by their group versus other industry players and the resulting economic effect, e.g. were the business restrictions (work from home, closure of business operations etc) applied on a stricter level than government recommendations? What is considered an industry standard response to COVID-19? Were there any unique circumstances which impacted your business and profits of particular entities due to COVID-19?

02 Losses and Allocation of COVID-19 Specific Costs

The OECD Guidance infers that the allocation of losses or exceptional costs arising from the COVID-19 situation should be consistent with the principle that the level of risks assumed shall correlate with the potential returns/losses of the parties to the transaction.

Multinational groups with regional hubs or global headquarters in Singapore need to consider whether such companies should bear any of the losses incurred in the market jurisdictions where limited risk companies are located.

Similarly, companies need to decide how the extraordinary costs (crisis response, redundancies, etc.) will be allocated between the entities. The key questions would be: What was the historical risk split between the principal and limited risk entities? How did the split of risks and authorities change over the course of the pandemic? How did the company or the group react in relation to agreements with third-party suppliers and customers? Who made decisions related to the COVID-19 response for the Group entities?



03 Government Assistance

The OECD Guidance describes various forms of government assistance, such as grants, subsidies, forgivable loan or other financial support, tax deductions and credits, salary support and staff retention schemes, etc. Among other factors, the OECD highlighted that mere offsetting of any government assistance against the cost base of the companies should not be performed without assessing the arm's-length behaviour.

IRAS has not provided any further indication on the treatment of the government assistance (other than the taxability of the support). However, some tax authorities (e.g. the Australian Tax Office) have taken a stricter view and stipulated that such benefits must be retained locally regardless of the circumstances.

The contrary views by different tax authorities could give rise to additional challenges for MNEs with operations across different jurisdictions to apply a consistent approach; while preference for prudent approaches may potentially lead to suffering of double taxation. The questions to consider by the companies include: How did the government support impact the economic results of the company? What would the company have done in the absence of such support? How did third-party suppliers/customers respond?

04 Advance Pricing Arrangements

The OECD underlined the fact that by default, taxpayers and tax authorities are still bound by the conditions of the existing APAs, unless the critical assumptions in such agreements have been breached.

IRAS is expected to take a practical approach, weighing in various conditions of the industry and the taxpayer as well as the position of the corresponding tax authorities in case of bilateral and multilateral APAs.

Companies with existing APAs and APAs under negotiation with IRAS need to assess how COVID-19 has impacted the conditions and results of such APAs, before they engage with IRAS to raise any COVID-19-related issues in a timely manner.

How we can help

The impact of COVID-19 and further economic changes varies in companies across different industries. Hence, any transfer pricing analysis or changes in the intercompany structures will need to be supported by the industry practice and contemporaneous documentation of the decision-making process.

We welcome the opportunity to discuss the impact of COVID-19 on your business. Relying on our vast expertise in various industries, we will be happy to work with you to address your concerns on the outcome of your transfer pricing model this year, support existing or new APA applications impacted by change in the economic environment, and identify potential opportunities that lie within today's world.

To uncover more insights on the global tax implications of COVID-19, read our [COVID-19 Global Tax Developments Summary]

Read more of our insights and perspectives at the [KPMG in Singapore Webpage]

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