

OECD guidance on transfer pricing implications of Covid-19: government assistance programmes

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As we carry on exploring the OECD's Guidance on the transfer pricing implications of the COVID-19 pandemic (the "Guidance") this article offers an overview of how government assistance programmes affect transfer pricing analysis.

Government assistance programmes

Government assistance is a monetary or non-monetary programme that provides eligible taxpayers with an economic benefit (e.g. a special grant, subsidy, forgivable loan, repayment deferral, easy terms, tax relief, investment, or additional payment) to support them and help manage their business during the Covid-19 pandemic.

The availability, content, duration and implementation of these programmes can all affect transfer pricing, whether government assistance is offered directly to a member of a group of multinational enterprises ("MNE") or available to independent parties in the market where the group operates, thereby affecting the behaviour and financial results of companies involved in comparable transactions.

The Guidance evaluates the significance and effects of government assistance programmes on the controlled transaction and the comparability analysis in a series of questions set out below.

1. Is government assistance an economically significant factor to be considered in a transfer pricing assessment?

Government assistance can have varying degrees of economic significance.

The Guidance says government assistance can be economically significant if it involves, for instance, wage subsidies, public debt guarantees, or short-term liquidity support. Under such conditions, government assistance can directly affect the controlled transaction and comparable transactions between independent parties, including their prices.

In other cases, government assistance can be less economically significant. For example, the provision of local government infrastructure may be only indirectly linked to the controlled transaction and its price.

There can also be cases where the parties to the controlled transaction do not receive government assistance, but independent parties do, and this can affect the comparability of transactions.

If government assistance is considered an economically significant factor affecting arm's length prices, an analysis of this factor should be included in the transfer pricing documentation to support the transfer pricing analysis.

It is important to note that in evaluating factors that affect transfer pricing, one of the economically significant characteristics to be assessed is the impact of government policy,¹ including government assistance.

2. Does government assistance affect the price of the controlled transaction?

The potential effects of government assistance on the price of the controlled transaction depend on its economically significant indicators. Thus, according to the arm's length principle it would be unreasonable to believe that only government assistance affects the price of the controlled transaction, without undertaking a careful comparability analysis (including analysis of how government assistance affects the prices of uncontrolled transactions).

The Guidance states that in assessing potential effects on the price of the controlled transaction, we should consider its economically significant aspects:

- The nature of assistance received (the availability, purpose and duration as well as other conditions the government might impose when granting assistance);
- The apportionment of economically significant risks;
- Competition and demand levels in relevant markets.

The Guidance emphasises that a mechanical approach should be avoided in applying a one-sided method (such as the cost plus method, the resale price method, or the transactional net margin method) to arrive at an arm's length price. For example, companies are advised against offsetting cost savings achieved through government assistance against the relevant cost base for the transaction, or recognising government assistance as revenue or extraordinary income, without first conducting a careful analysis of the factors affecting the transaction, because the controlled transaction can end up having a price that is not arm's length.

3. Does government assistance affect the apportionment of risks in the controlled transaction?

The Guidance states that while government assistance can reduce the adverse quantitative effect of transaction risks, it will not change the apportionment of risks between the parties to the controlled transaction. Its contractual terms, the company's opportunities and the actual performance of functions in the transaction will remain unchanged regardless of government assistance.

For example, a party taking credit risk might expect a loss from the other party because of its financial distress. Yet the other party is in fact able to carry out its obligations because of government assistance. This aspect (i.e. a reduction in the adverse effect of a risk) should be distinguished from risk apportionment.

4. Does government assistance affect comparability analysis?

Government assistance can affect how the parties to the transaction establish their commercial or financial relationships and how they price their transactions. Thus, when conducting a comparability analysis, including a review of likely comparables, additional comparability criteria may be necessary to take account of government assistance.

Government assistance and the special circumstances surrounding the Covid-19 pandemic can vary from market to market, with different effects on arm's length prices in uncontrolled transactions. So, when it comes to finding reliable comparables, the safest approach is to maximise the use of data on comparable uncontrolled transactions (for companies performing similar functions, taking similar risks and using similar assets) in the same or a comparable geographical market.

When comparing transactions, we should also evaluate how the MNE group member and comparable independent parties record government assistance in their books, especially if each party applies different accounting standards, which may affect different profitability levels (gross profit, operating profit, net profit etc). A comparability adjustment may be required in such cases. Differences in the accounting treatment of government assistance can also indicate different types of assistance.

Our next article will be exploring the other topics of the Guidance, i.e. losses and the allocation of Covid-19 specific costs, and an advance pricing agreement.

¹ The Cabinet of Ministers' Rule No. 677, *Application of Provisions of the Corporate Income Tax Act*, paragraph 11.1, and the OECD Transfer Pricing Guidelines, Chapter I, section D.4