

Tax authority's guidance on transfer pricing during Covid-19 pandemic (1) 3/11/22



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The world and things keep changing, and this change is affecting the environment significantly – both positively and negatively, allowing and even forcing us to revise various processes and activities to make them consistent with the reality. These factors are also affecting transfer pricing (TP).

Companies that make related-party transactions and are liable to prepare and file TP documentation should focus on applying TP objectively and documenting their controlled transactions for the financial years affected by the pandemic. To facilitate this process, on 19 January 2022 the State Revenue Service (SRS) has **prepared guidance** with key information on factors to consider in preparing TP documentation for the financial years affected by the pandemic. We note that this guidance is derived from the Guidance on the Transfer Pricing Implications of the Covid-19 Pandemic the OECD published on 18 December 2020. It is understood that the documentation for the financial year 2020 – the first period affected by the pandemic – has already been filed, and the guidance is well overdue, yet its publication allows us to correct our mistakes. We offer a series of two articles exploring the SRS guidance with insights for the coming periods affected by the pandemic.

Economic changes, restrictions, business incentives, financial aid from the government, uncertainty and other pandemic-related circumstances make it difficult to apply TP objectively. In its guidance the SRS has singled out a number of key factors to consider for TP during the pandemic. This article explores the first two of them:

1. Factors directly affecting the TP treatment during the pandemic
2. State aid received

Factors directly affecting the TP treatment during the pandemic

To prove that their TP has changed because of the pandemic and not because of any other circumstances, it is important for companies to include in their TP documentation descriptions of those circumstances and supporting information leading to the relevant conclusions. All the information must be true, comparable and complete.¹ It is crucial to give any information on how the pandemic has affected the industry as a whole, on the functions the company has performed, any associated risks and assets used, on changes to comparable transactions between unrelated parties and a selection of unrelated comparable companies that will give the SRS an understanding of the TP policy the company used during the pandemic. When reviewing particular chapters of the TP documentation, the descriptions of controlled transactions should be carefully considered to add the following information:

- Relevant macro-economic data for the industry or country during the pandemic published by the central bank, the government, associations and organisations or available on public databases
- Statistics and their analysis relating to the company's industry or line of business

In preparing the functional and economic analyses of transactions, we should consider the following information:

- Economic quantities describing how the pandemic affects controlled transactions (including analysis of financial information of the group and/or the parties to the transaction)
- Sales volumes, production capacity utilisation, costs and other key factors (it may be useful to prepare quarterly financial statements)

The chapter on critical assumptions supporting the company's TP methodology should include the budget plan and its performance analysis – a comparison of the budgeted and the actual results and information on comparable unrelated parties' behaviour during the pandemic and previous stages of economic downturn.

State aid received

To mitigate the adverse business implications of the pandemic, the Latvian government has made available various aid tools for business, so we need to assess whether and how the aid received has affected the prices of controlled transactions and comparable indicators. This can be done by including in the functional analysis of controlled transactions and benchmarking study additional information on the state aid received, stating its type and giving an evaluation of whether and how this aid has affected the TP applied.

According to the SRS guidance, in analysing the aid received, the following questions should be considered:

1. Does the aid provide market advantages?
2. Has the aid contributed to an increase in revenues and/or to a reduction in costs?
3. Is the aid (cash, advantages) being used to settle with independent customer or suppliers? And to what extent?
4. How would independent comparable companies use the benefits created by the aid?
5. What is the impact of the aid on the functions performed by the parties to the transaction and on the apportionment of risks?
6. What are the government procedures and potential differences in accounting? And how does this affect the comparability of the chosen profit level indicator?
7. What are the financial reporting requirements in the residence countries of comparable independent companies (any required comparability adjustments)?

When we look at the first two factors the SRS has singled out as affecting the TP treatment during the pandemic, we get the impression that they minimise the uncertainty and give a clearer picture of what matters in setting TP for interim periods. Yet this guidance also seems likely to increase the administrative burden in terms of defending TP.

We will look at the other factors affecting the TP treatment during the pandemic in our coming Flash News edition.

¹ Section 2 of the old Accounting Act (ceased to apply from 2022) and [section 5 of the new Accounting Act \(effective from 2022\)](#)