

COVID 19'S IMPACT ON TRANSFER PRICING AND ECONOMICS BEHIND IT

KANUPRIYA PRASHAR
KPP ADVISORS AND GOVISORY
SERVICES

MODERN TIMES - 2020 DECADE OF COVID 19 VIRUS

- ❑ Economic Impact - Macro level
- ❑ Industry Impact - Macro level
- ❑ Company Impact - Micro level
- ❑ Transfer Pricing Life Cycle Impact
- ❑ Transfer Pricing Challenges
- ❑ Transfer Pricing Considerations
- ❑ Case Study - Amazon Business Impact a Positive
- ❑ Learnings from Past Crisis

ECONOMIC IMPACT - MACRO LEVEL

- ❑ Recessionary pressures in short to long term with irreparable damages in-terms of human life losses.
- ❑ Oil price in negative - price of WTI
- ❑ Job losses and decline in disposable incomes resulting in less per capita consumption
- ❑ High operational losses due to downward economic pressures (lockdown costs, salary costs and interest) with less consumption due to less demand
- ❑ Frugal economy - Less is more due to job losses
- ❑ Supply driven economy - there would be excess supply with less or no demand due to lower disposable incomes
- ❑ Supply chain rearrangements - need to revive logistics so that supply chain isn't clogged

INDUSTRY WIDE IMPACT - MACRO LEVEL

- ❑ Business Restructuring as a result of recession and persistent losses
- ❑ Supply chain rearrangement due to changes in manufacturing/sourcing destinations
- ❑ Operating model review where companies shift manufacturing from China to India for example.
- ❑ Regular review of business plans to increase margins and revenue and hence bottom line
- ❑ Increased cost pressure and difficulty in justifying contingency costs
- ❑ Increased use of business transformation tools like Robotics to remove redundancy and increase Bottom line
- ❑ Business form and substance to be justifying the end results
- ❑ Increased transparency and clarity of business objectives both in the short and long run
- ❑ Operating losses as a result of decline in margins and mark-ups
- ❑ Job losses leading to lower disposable incomes

COMPANY IMPACT - MICRO LEVEL

- ❑ Drop in sales revenue due to downward pricing pressures as a result of supply driven economy rather than demand.
- ❑ Increase in contingency costs such as laptops, during lockdown
- ❑ Global losses for the MNC operations - profit/loss allocation across multiple jurisdictions.
- ❑ Changes in operating model - use of digital economy

TRANSFER PRICING LIFE CYCLE IMPACT

❓ Transaction Structuring and Pricing

- ❓ Business restructuring and changes in tangible and intangible pricing as a result of cost and pricing pressures to sustain a declining demand

❓ Government Policy

- ❓ Changes required in TP disclosures and testing requirements like changes in TP methods for benchmarking purpose

❓ Advance Pricing Agreement

- ❓ Exclude extraordinary years like 2020 and 2021 from overall tax agreement with government

TRANSFER PRICING LIFE CYCLE IMPACT

❓ Planning for Base Erosion and Profit Split

- ❓ Impact on financing transactions, profit/loss allocation

❓ Country by Country Reporting

- ❓ Changes in template for recording such one-off transactions with far reaching impact on business outcomes

❓ Litigation Support

- ❓ Challenges by tax authorities discussed in detail in later slides. More collaboration, empathy and collectivism required.

TRANSFER PRICING CHALLENGES

- ❓ Decline in earnings/margins/profitability
- ❓ Decline in cost base and hence decline in cost plus mark up. Mark-up rates would decline as a result of benchmarks.
- ❓ Difficulty in applying global benchmarks for similar functions, assets and risks depending on Covid's impact on the local economy
- ❓ High variance in earnings and profitability from comparable period of 3-5 years and impacting economic life cycle of a business
- ❓ Lowered cash tax expenses resulting in lowered tax collection by government
- ❓ Contingency costs claimed by tax payer which are one -off in nature and unable to claim deductions on the same since these are non-operating and extraordinary in nature.

TRANSFER PRICING CONSIDERATIONS

- ❑ Application of TP methods like TNMM, Cost plus, Profit split be..can they be modified with new business/economic reality?
- ❑ Benchmarking comparable data for 2020-2021 would be available much later
- ❑ Allocate risk to limited risk service provider or a limited risk distributor
- ❑ Parties argue force majeure
- ❑ Treatment of extraordinary costs during Covid period
- ❑ Impact of credit period offered to affiliates during the crisis period

AMAZON BUSINESS - A CONTRARIAN VIEW

POSITIVE IMPACT ON ONLINE BUSINESS

- INCREASED SALES REVENUE
- POSITIVE IMPACT ON ONLINE BUSINESS CONTRARY TO BRICK AND MORTAR TRADITIONAL BUSINESSES
- INCREASED DEMAND AND SUPPLY OF GOODS AND SERVICES
- HIGHER GLOBAL OPERATIONS - INCREASED PROFIT ALLOCATION BETWEEN GLOBAL SUBSIDIARIES - PROFIT SPLIT METHOD

LEARNINGS FROM THE PAST CRISIS - NATURAL AND MANMADE CALAMITIES

Years Later, Lessons from the Financial Crisis. 8.8 million jobs lost. Unemployment spiked to 10% by Oct 2009. 8 million home foreclosures. \$19.2 trillion in household wealth evaporated. Home price declines of 40% on average – even steeper in some cities. S&P 500 declined 38.5% in 2008. \$7.4 trillion in stock wealth ...

What are learnings from Covid 19 crisis....on-going analysis.....