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ATO guidance on transfer pricing in COVID-19 times

On 19 June 2020, the ATO issued two pieces of guidance on transfer pricing matters in the COVID-19 environment:

1. COVID-19 economic impacts on transfer pricing arrangements

2. Changing related party agreements

How the ATO assess COVID-19 economic impacts on transfer pricing arrangements

The ATO acknowledge that businesses will be negatively impacted by COVID-19 by way of reduction in revenues, increased expenses, and changes to profit outcomes. Taxpayers are expected to support the arm's length nature of their transfer pricing outcomes through

- A detailed profit and loss analysis showing changes in revenue and expenses, with an explanation for variances resulting from COVID-19 (this may include a variance analysis of budgeted (pre-COVID) versus actual results
- Details of profitability adjusted to where taxpayer's outcome would have been if COVID-19 had not occurred (this should consider all factors that have a positive or negative impact on profits and should be supported by evidence)
- The rationale and evidence for any increased allocation of costs or a reduction of sales (and subsequent changes in operating margins) to the Australian entity, taking into consideration its function, asset and risk profile
- Evidence of any government assistance provided or affecting the Australian operations.

The ATO is not planning to provide taxpayers a 'safe-harbor' framework as to COVID-19 impacted profit ranges. This means taxpayers need to put in place sufficient documentation to demonstrate individual facts and circumstances in the COVID-19 environment.

Taxpayers with an advance pricing arrangement may face a breach of the critical assumptions, and are encouraged to engage with the ATO to agree alternatives.

Changing related party agreements

While the ATO acknowledges economic effects of COVID-19 has placed pressure on businesses to review their operations, the ATO are aware of communications suggesting tax advantages by changing related party arrangements in the COVID-19 environment. Examples include:

- Triggering tax deductions for foreign exchange losses by early termination or repayment of liabilities under related party financing agreements
- Avoiding ongoing withholding obligations on amounts payable to overseas parties by changing related party agreements.
- Reducing assessable income from rights or property provided to overseas related parties by changing related party agreements
- Increasing contractually assumed risks and allocation of global economic losses for limited risk entities by changing related party agreements.

The ATO will be reviewing changes of these kinds by examining documentation to assess whether the changes reflected arm's length behaviour, resulted in a mismatch between substance and legal form, associated with a purpose of obtaining an Australian tax benefit.

What the taxpayer should do

The ATO guidance provides a timely insight into how they expect taxpayers to self-assess and document the adverse impacts of COVID-19 on transfer pricing arrangements.

Typically, transfer pricing reviews are likely to spike in years with tough economic conditions such as COVID-19. While the guidance may appear abstract and intractable to taxpayers, our global transfer pricing experts can assist you finding the bearings and ensuring things are in order for potential ATO queries.

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