



TRANSFER PRICING FLASH

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COVID-19 Implications on Transfer Pricing Arrangements

We understand that you are grappling with the increased challenges from the current pandemic. However, we wish to remind that it is equally important to manage your transfer pricing ["TP"] compliance matters in line with the local TP requirements.

With current economic crisis, managing cash to ensure sustainability of business is critical. Organisations are under pressure to revisit their current business models, pricing policies, supply chain, resource management and trade contracts. Hence, many TP issues will arise among those organisations which transact with each other within the group. **Renegotiation of terms of contract** such as payment term or financial support within entities in a group will be imminent. Companies with bleak outlook of their operations may be faced with the option of **restructuring their businesses** or **reorganising some functions and risks**, as decisions are and will be made whether to downsize or shut down the whole or part of the business or merging of two businesses into one or to relocate some business functions. These arrangements involving entities within an organisation will inevitably be exposed to TP risks as their characterisation and risk and return profile change.

There will be other businesses which may not be able to record the same positive results or earning their routine returns that they have been recording pre-COVID-19 crisis, due to disruption in supply chain, production, workforce, market demand and other factors. Many companies will be absorbing huge operating costs that deplete their profits. **Sudden plunge of results**, from high to low profits or losses, will trigger attention for audit by tax authorities worldwide. Meanwhile, with regard to **companies assuming low risks that have been compensated with a fixed return** by their principals, the tax authorities do not expect that the said return being reduced by the principals who have to absorb increasing costs arising from the current crisis, without any change in functional and risks profiles of the low risks companies. In fact, with the rise in operating costs during this crisis period, tax authorities worldwide will scrutinise closely and even more on related party transactions to ensure that such costs are not being unfairly passed on from one party to another. In other words, related parties are still expected to transact with each other in a commercially rational manner in the same way they would with independent parties. This is the arm's length principle which they must adhere to.

Whatever changes the companies are going through or plan to implement, it calls for in-depth review of the TP arrangements to understand the changes of functions and risks among the entities and thus, will lead to adopting a different approach on the preparation or updating of TP documentation. The **substance** of the transactions or arrangement must be reviewed and enhanced to defend the arm's length nature of the transfer price.

As there is no definite sign of the slowing down of the pandemic, it is already expected that the effects of the COVID-19 on businesses will likely to be long term. In spite of this, however, businesses should not manipulate the current conditions for purposes of gaining tax advantage the unlawful way.

Preparing for the Change

As TP audits will continue and may not decelerate post Movement Control Order ["MCO"], it is utmost critical for organisations to manage their TP relationships and arrangements well, in order to mitigate their TP risks. Whether the changes to the business is temporary or permanent, the changes must be consistent with valid facts and substantiated with appropriate documentary evidence. The proposed change in the business arrangement must be carefully thought and planned before being executed. Keeping good records and proper supporting documents, in addition to having a well-documented and robust TP documentation, are advisable to support the "new normal" results, which could span a few years, or business arrangements to justify the TP positions. Not having a well-documented TP study in place will cause unnecessary distress during TP audit disputes.

Entrust Us with Assisting Your Organisation

Whatever challenges you are facing or decisions you have to make, you may reach out to our TP consultants at Moore Advent Malaysia for assistance. In addition to TP compliance and risk assessment study, our services also include TP planning and advisory. We could assist to review your existing and proposed new contractual arrangement and advice you on the TP implications arising from the changes. We provide support for the development of TP policy, contractual arrangement, tax-efficient business structure through legitimate planning and comprehensive TP study.

Strive to protect your organisation's TP position by being tax compliant. Please feel free to contact us at tax@moore.com.my.

Stay Safe, Stay Compliant

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