

INTERNATIONAL TAX SERVICES

TRANSFER PRICING IN TIMES OF CRISIS - CHALLENGES FOR ENTERPRISES



Unpredictable political and economic developments such as the current Corona Virus Crisis can have a significant impact on the global economy. As a result of the decline in demand on the world market caused by the Corona Virus Crisis, aggravating production and sales processes as well as labor law challenges, many multinational enterprises (MNEs) suffer significant reductions in profits, or even more, suffer losses. The current coronavirus pandemic trigger enormous challenges for the global economy and requires rethinking of existing structures and, in some cases, also (temporarily) redesigning existing transfer pricing models.

ARM'S LENGTH PRICE-SETTING FOR ROUTINE COMPANIES

So-called routine companies have been established in many MNEs in the last years. Routine companies, e.g. distribution companies, contract (toll) manufacturer or low-risk distributors (LRDs) should generally achieve low, but relatively stable profits. Although it is often no longer possible for the group to realize profits as a result of the disproportionate economic decline in demand or prices, these routine companies generate taxable profits. In this context, the question arises whether routine companies are still entitled to achieve target profit margins, which were determined based on significantly more favorable market and competitive conditions, while the entire group has already slipped into the crisis. Under certain conditions, it can be compliant with the arm's length principle that routine companies temporarily forego profit elements or even generate losses in times of crisis.

COMPARABLES FROM DATABASES

The target margins for routine companies, e.g. profit markup, gross profit or EBIT margin are regularly determined using specialized benchmark researches, which are based on the financial data of previous financial years. The actual developments, such as crisis-related losses, are obviously reported with a time delay in the financial statement, so that the databases on which the calculation of the target margins is grounded considers significantly more favorable market and competitive conditions. It is highly recommended to check existing benchmark analysis and, if necessary, adjust the agreed target margins so that the crisis' effects can be considered accordingly.

LOSS SPLIT SOLUTIONS

In special/extraordinary situations, it might also make economic sense to „split“ losses between various associated companies. This has especially to be considered in case of integrated value chains, in which each company within a value chain provides significant contributions to the success of the group. All companies involved have an economic interest to keep the value chain alive. Therefore, support measures within the value chain and also between participating co-entrepreneurs should be considered. These should be based on arm's length financial models which reflect comparable situations.

ABOUT BDO

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BUSINESS RESTRUCTURING / SUPPLY CHAIN

Optimizations of the transfer pricing system in the form of changes in the group structure or the transfer of functions, risks and intangible assets often fulfill the requirements of the "transfer of functions" regulations and thus triggers a "transfer package" exit taxation. However, in times of crisis operational functions often show significantly lower profit potential or even loss potential so that a transfer of functions in less profitable times have far less serious consequences than in profitable times. In order to be prepared for an economic upswing, the "opportunities" in the crisis should be used. It is highly recommended to consider business restructurings and transfer of functions now. The same principles should be applicable in case of a transfer of functions from abroad to Germany, e.g. to make a supply chain "crisis-proof".

INTRA-GROUP FINANCING

The interest rate of an intra-group loan depends on many influencing factors such as the borrower's creditworthiness or, in the case of pass-through loans, on the refinancing costs. In times of crisis, the creditworthiness determined on a stand-alone basis might have changed significantly, so that a higher risk premium would be required from banks. A deteriorating credit rating can also impact the cost of funds of the lender (associated company) in the form of an increase in the risk premium. It should be checked whether and to what extent the agreed financial terms and conditions can still be regarded as at arm's length taking into account the conditions which have changed. The same applies to the terms and conditions of other financial transactions such as guarantees.

ACTION REQUIRED

The possible effects of the coronavirus pandemic crisis in the context of MNEs should be examined now. Feasible measures such as cost-reduction programs or possible interventions in existing transfer pricing models should be considered. Most companies are currently suffering decreasing profits or losses. It should also be remembered that Corona Crisis does not only pose risks for MNEs, but also offers possibilities of a reorganization or redesign of previous transfer pricing models which can reduce tax consequences.

EFFECTIVE SUPPORT BY BDO

BDO experts are committed to delivering feasible measures and help you manage your company through the crisis. In order to be able to exploit the upcoming challenges worldwide, we are able to involve colleagues from BDO member firms in our international network, which is active in more than 160 countries across the globe.