Now that we have uncovered the core of our intentions, we just need to make the same magic happen under the constraints of 2021 – the COVID era.

Rather than focusing on what we can't do – travel – I suggest we focus on what we can do – **everything else!**

So yeah, we could go on and on about all the restrictions and new regulations we must adhere to, about how effective online conferences are or, rather, are NOT! We could discuss that most of the significant connections made during in-person conferences are usually during the most spontaneous and unplanned moments – in the lift, on the sidewalk, in the line for the loo... (all these are real stories for another day)! But NO, we will not mourn our past ways; we will look forward to the new era and all the glorious advantages that lie ahead. Ok, sorry, I'm getting carried away... but I can't help myself!

In May 2020, our firm launched #ipandbeyond, a streamlined process for our lawyers to reach out to the firm's many friends, colleagues, and acquaintances from around the globe. These one-on-one, 40-minute, and often longer, face-to-face, casual Zoom meetings, allowed us to not only get a glimpse of their homes, their kitchens, and often of their children, but of our shared fears, hopes, and our agility, both personally and professionally, in facing this global epidemic. We began #ipanadbeyond as an initial gut reaction to all that was happening around us. We felt a deep desire to touch base and reach out to our network on a personal level, as many have been a part of our lives for over two decades, spending, at the very least, a few weeks a year together!

In fact, #ipandbeyond encompasses our core – creating and maintaining substantial relationships, with the very same intention of offering superior, expert legal services in IP & beyond in a creative and pleasant environment. It is as simple as that. We need to continue to reach out and offer not only our time but our empathy as well as our advice. We must ensure new ways of communicating with new and old acquaintances. My mind often wanders back to some of Soroker and Agmon's "war stories" of the early days at global conferences, when they were only dozens of participants and not thousands, where the connections made were real and long-lasting. I can't help but feel that each of us is craving those moments now, of a more intimate and empathetic connection.

Simply put – the bottom line when planning 2021, no matter which marketing tool we apply – 2021 is the time to actively listen, study, and understand what our friends, clients, colleagues, and associates might need beyond what we have been offering them; it's the era of IP & beyond.

## INTERNATIONAL TAXATION PG (ITPG)

# COVID-19 and Its Effects on Transfer Prices of Routine Companies

**By Oliver Biernat**

COVID-19 currently has a massive impact on our lives and our economy. Many companies experience declining sales and profits, some industries even struggle to survive. Therefore, in internationally operating groups the question arises as to how the unplanned fluctuations in operating results can

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be adequately taken into account and documented in transfer prices.

## Adjustment Processes and Their Documentation

The key question is whether the disruptions are temporary or reveal deeper, systematic problems. If adjustments to the remuneration of a group company are envisaged, these should be adequately reflected in the relevant contracts and in the group-wide transfer pricing system. Adequate documentation is crucially important in this respect.

The economic reasons and arguments for the adjustments should be documented in writing so that they can be defended in the event of a subsequent audit, after the COVID-19 crisis is (hopefully) long over and any employees involved may have left the company.

## Principle

Under normal circumstances the group company, which carries out the most important and valuable DEMPE activities, bears the corresponding risks, and is entitled to the residual profit, must bear any losses. Afterwards, it is examined whether routine companies can participate in the losses of the group.

If the transfer price is not calculated according to the cost-plus method, transfer price studies are usually prepared for routine companies to make plausible and document a remuneration that is customary for a third party. However, it is clear that the data currently available in relevant databases does not yet reflect the effects of COVID-19. This will only be the case in the financial statements for 2020, which will probably not be available in the databases until the

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end of 2021. Therefore, the question arises how affected internationally operating corporations can react.

## Options (Possible Solutions)

The following four options are conceivable to seize the risk by the tax authorities:

1. consistently maintain the chosen routine remuneration ("do nothing");
2. reduction of the remuneration within the bandwidths to the lower quartile;
3. reduction of the remuneration to break even;
4. share losses proportionately with routine companies (in this option there is an increased audit risk. Therefore, a solid justification and appropriate documentation is strongly recommended).

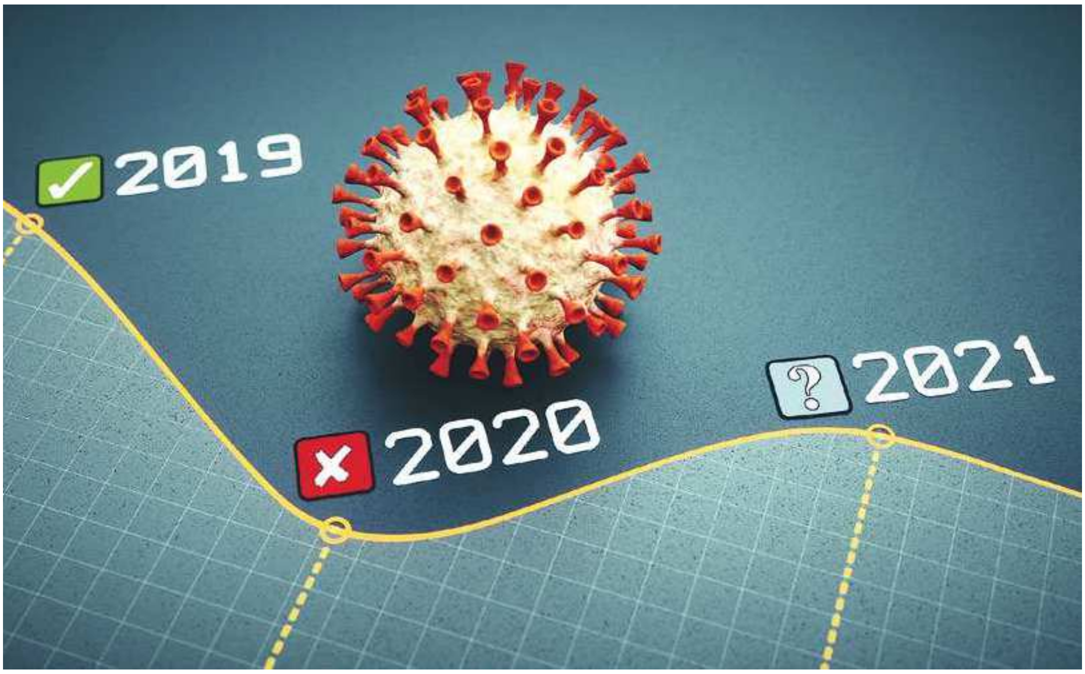
These options are discussed below.

1. Maintaining the routine fee only seems to make sense if the overall profitability of the company has not been unduly affected by COVID-19 and related measures.
2. A proactive adjustment of the remuneration within the interquartile bandwidths at TNMM could still be documented as pricing at market conditions, as companies independent of the crisis are free to choose any point within the bandwidth anyway, according to the OECD. Such an approach could serve as a useful transitional solution. If profitability recovers, the remuneration should already be increased again in the following quarter in order to disprove the allegation of abuse.
3. If the entire group is in a loss situation due to COVID-19, the question arises whether the profit element for routine companies could also be reduced to zero. Most tax authorities argue that routine companies should in principle not achieve zero return. However, even routine companies bear limited risks. Even if routine companies would only achieve a zero return, the parent company still bears the main risks in the value chain.
4. Another very drastic option would be to split the losses, e.g., if routine companies are not designed as zero risk companies. A common methodology would be, for example, to cover only the fixed costs of these group companies, which means that the parent company/entrepreneur still bears the bulk of the losses.

Options 3) and 4) should only be considered if the relevant intra-group contracts contain a force majeure clause, or at least a hardship clause, and thus a reference to "force majeure", or the exceptional situation, is possible to justify a (ideally short) period of loss sharing. Ideally, the general terms and conditions of business provide that internal group agreements can be adjusted or terminated if certain events occur. However, such a high reduction of the remuneration enormously increases the risk of being taken over by the tax authorities.

## OECD Approach

On 18 December 2020, the OECD released a report containing guidance




on how the arm's-length principle and the OECD TP Guidelines apply to issues that may arise in the context of the COVID-19 pandemic. In Chapter II, Sec. 2, the report deals with the question if entities operating under limited risk arrangements can incur losses. Since the term "limited-risk" is not defined in the OECD TPG it is not possible to establish a general rule that entities so described should or should not incur losses and it will be necessary to consider the specific facts and circumstances, especially the risks assumed by an entity.

For example, where there is a significant decline in demand due to COVID-19, a "limited-risk" distributor that assumes some marketplace risk may, at arm's length, earn a loss associated with the playing out of this risk. In this example, the TNMM, or potentially the resale-minus method, might be the most appropriate methods, and third-party comparable distributors might in these circumstances earn a loss, which might arise if the decline in demand means that the value of sales is insufficient to cover local fixed costs.

However, it will not be appropriate for a "limited-risk" distributor that does not assume any marketplace risk, or another specific risk, to bear a portion of the loss associated with the playing out of that risk. For instance, a "limited risk" distributor that does not assume credit risk should not bear losses derived from the playing out of the credit risk. For this reason, when determining whether an entity operating under limited risk arrangements can sustain losses, the guidance in Chapter I of the OECD TPG, particularly as it relates to the analysis of risks in commercial or financial relations, will be particularly relevant.

## Procedural Steps

A five-step approach is recommended:

1. In a first step, it should be examined how independent third parties behave on the market and whether changes to agreements between third parties could also serve as a qualitative argument for a possible change or termination of intra-group contracts.

2. In a second step, the agreements must be assessed in the light of the new operational reality in order to define an appropriate, i.e., market conform, response.

3. In a third step, the legal justification for an adjustment to the contractual framework must be worked out precisely.

4. In the long term, it is also crucial to document precisely the analysis and the justification for the decision to change or even terminate an intra-group contract in order to be prepared in case of a possible future audit.

5. In a final step, the contracts should be amended (or terminated) and signed so that they can be legally enforced.

## Summary

In summary, the following three steps are recommended:

1. **Evaluation:** Determination of how the main consequences of COVID-19 for the operational business affect the transfer pricing system of your company, which risks arise, and how material these are in each case.

2. **Adjustments:** Based on the first step, appropriate temporary or permanent adjustments of the remuneration mechanisms can be planned.

3. **Documentation:** Simultaneously with the planning and implementation of adjustments to the transfer pricing system, these should be carefully documented to have a solid basis for the economic adequacy of the adjustments made. This step should not be underestimated, as subsequent documentation will be much more time consuming, especially in the case of extraordinary measures such as those required by the current crisis.