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# Transfer Pricing in Uncertain Times – The Changing Asia Pacific Landscape

## Presenters

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Steane Hainsworth



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## OUR SERVICES

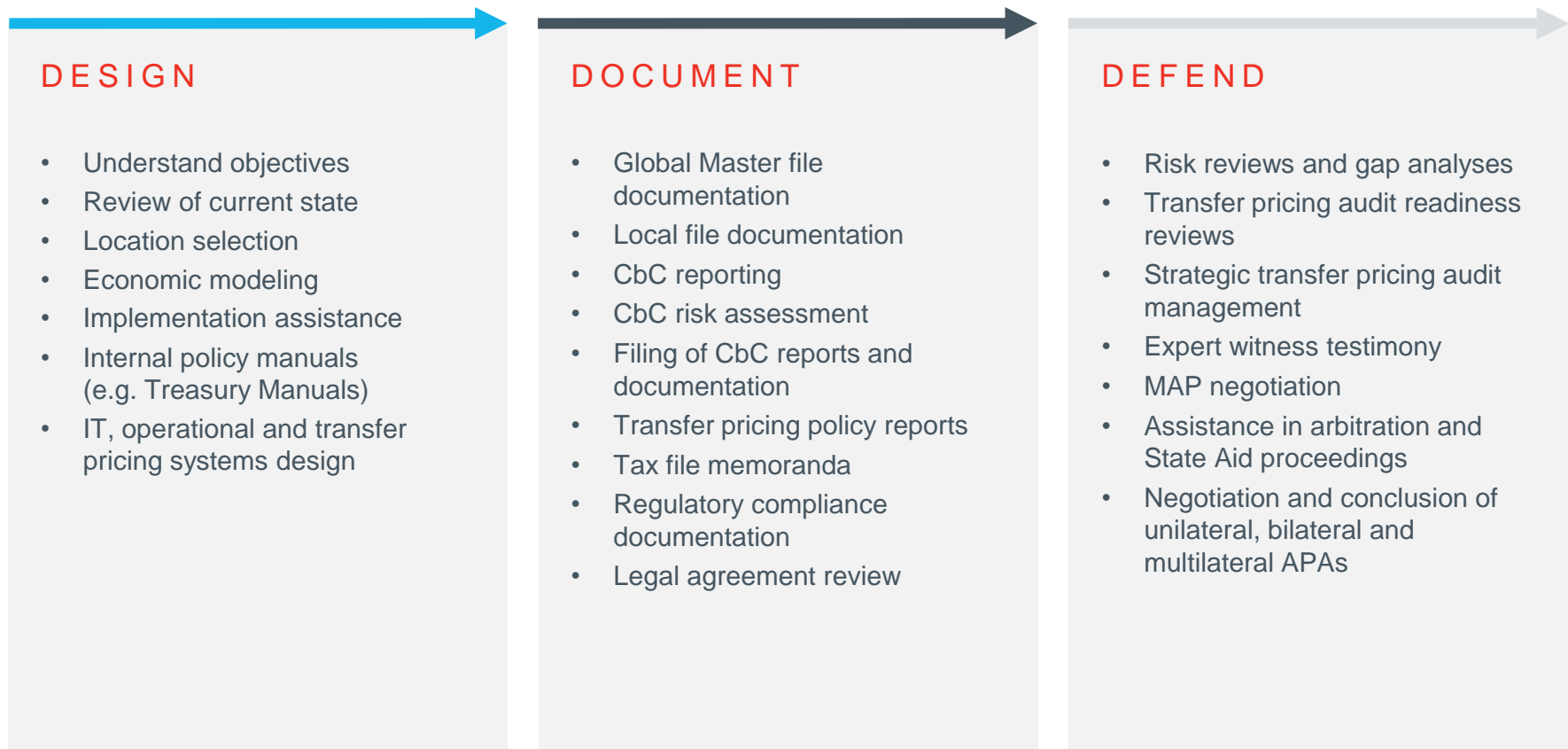
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- OECD Policy Analysis and Implementation
- Transfer Pricing Risk Assessment, Strategic Planning and Due Diligence
- Intercompany Finance Policy Development and Support
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# AGENDA

- 1. Supply Chain:** Implications for internal contracts and historic divisions of risk within multinational groups and the challenges of relying on one-sided pricing methods in crisis environments
  - » [Douglas Fone](#), Managing Director, Asia Pacific Transfer Pricing Leader, Singapore
  - » [David Lewis](#), Managing Director, Australia Transfer Pricing Leader, Melbourne
- 2. Financial transactions:** Effect on tax and treasury policies for intercompany funding to manage the cash needs of multinational groups
  - » [George Condoleon](#), Director, Transfer Pricing, Sydney
- 3. Tax administration:** Near-term impacts on Advance Pricing Arrangements (APAs), Mutual Agreement Procedure (MAP) discussions, litigation, audits and documentation deadlines
  - » [Steane Hainsworth](#), Director, Transfer Pricing, Brisbane



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**Supply Chain: Implications for internal contracts and historic divisions of risk within multinational groups and the challenges of relying on one-sided pricing methods in crisis environments**



# Topics

- Challenges facing tax directors
- Risk and the supply chain
- Extraordinary expenses
- Sharing profits and losses
- Challenges in benchmarking
- Risk management



# Business Priorities



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# Transfer Pricing and Business Priorities in Response to COVID-19

- Challenges facing MNEs
- Impacts on traditional entrepreneurial supply chain models
- Are your transfer pricing policies and the transfer pricing architecture fit for purpose to manage the effects of the pandemic by allowing flexibility to manage the impacts through the supply chain and support outcomes?

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# Transfer Pricing and COVID-19 Supply Chain Considerations: Risk

- Typical limited risk entities in centralised models:
  - Contract manufacturers
  - Limited risk service providers
  - Limited risk distribution entities
- Are they really limited risk?
  - Use of one sided methods
  - Impact of the intercompany agreements
  - Labels
- Need to understand their risk characterisation based on specific facts and circumstances to determine flexibility to absorb some of the impacts of COVID-19 on the supply chain
- Ability to amend agreements if necessary
  - Options realistically available
- Revenue Authority attitudes



# COVID-19 Issues



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# COVID-19 Impacts on Supply Chains

- Extraordinary expenses:
  - Inventory write offs
  - Unrecovered fixed costs
  - Higher marketing and advertising costs
  - Bad debts
  - Employee redundancy costs
  - Other restructuring costs
- Should these be borne by the entrepreneurial entity in the supply chain or the low or limited risk entities?
- How do you apply the transfer pricing method?
- Channel losses – should these be borne by the entrepreneur or shared through the supply chain?
  - Change of method?
- Renegotiation of royalties or temporary relief
- Adjusting margins to reflect economic impacts



# Benchmarking



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# Arm's Length Benchmarking in a Year of Crisis

**How do you benchmark the profit that related parties should be targeting in 2020, in the face of the current crisis?**

## **Starting with the prior year benchmark:**

- Reconsider the selection and rejection of comparables
  - Acceptance of comparables with operating losses
  - Do not apply a loss screen in the database search
- Select a point between the lower quartile and the median
- Consider selection of a specific (lower) point in the range, if that is most comparable
- Make adjustments to the prior year benchmarking results to reflect the decrease in profitability seen in the wake of past economic crises, e.g. GFC, but:
  - COVID-19 is affecting industries differently and to different extents...

## **In future benchmarking studies for compliance documentation:**

- Greater importance for industry comparability
- Consider applying screen for similar declines in revenue

# Managing Risk



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# COVID-19 Risk Management

**On the other side of this pandemic, revenue authorities will be very active on MNEs and transfer pricing as they were after the GFC**

Documentation of price-setting policies:

- Transfer pricing policy paper
- What were the options that were realistically available
- What were the commercial reasons for decisions made
  - Business restructuring
  - Short-term loans, rebates, discounts, etc.
- What were the commercial reasons for losses incurred
  - Industry-wide
  - Company-specific
- Quantification of the losses incurred as a result of COVID-19
  - To allow adjustments to be made in future

Documentation for price-checking or compliance purposes:

- In accordance with local requirements and tax office expectations
- If any changes made in transfer pricing model or benchmarking, beware impact on prior year disputes



# Summary



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## Takeaways

- Carefully consider the risk profile of limited or low risk entities in your supply chain. Review the agreements and consider amending where appropriate. Manage the risk of compensation being required
- It may be appropriate for limited risk entities to bear extraordinary expenses that they incur as a result of COVID-19
- Sharing of channel losses may be appropriate
- For pricing of related party transactions in 2020
  - Adjust benchmarking from prior years to account for the impact of COVID-19
  - Amend pricing in light of current facts and circumstances and be able to demonstrate this as arm's length behaviour
  - Prepare documentation to evidence
    - » The price-setting policies
    - » The commercial reasons for decisions made and for losses incurred
    - » The options that were realistically available at the time
  - Documentation is valuable risk management tool

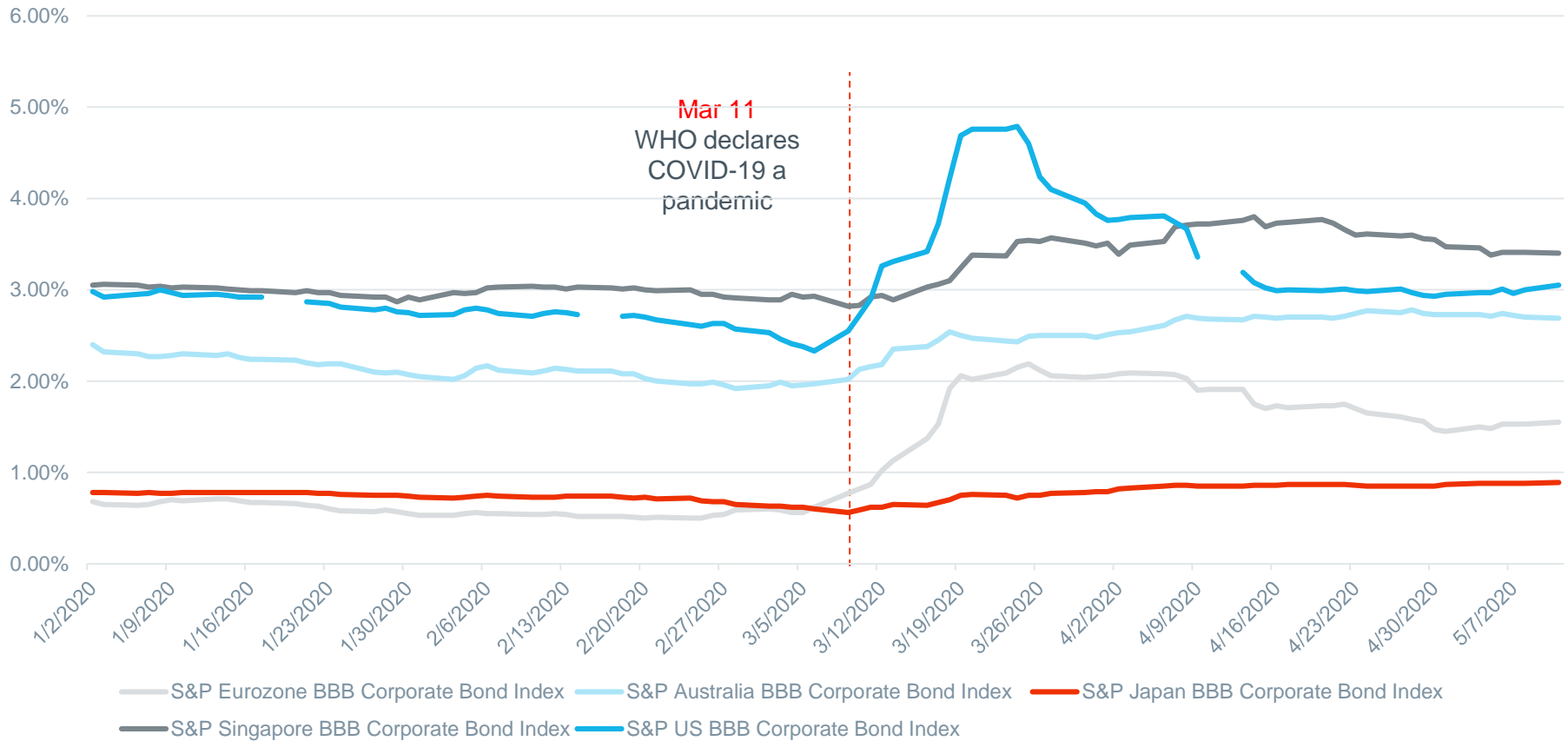
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**Financial transactions: Effect on tax and treasury policies  
for intercompany funding to manage the cash needs of  
multinational groups**



# Direction of Credit Markets

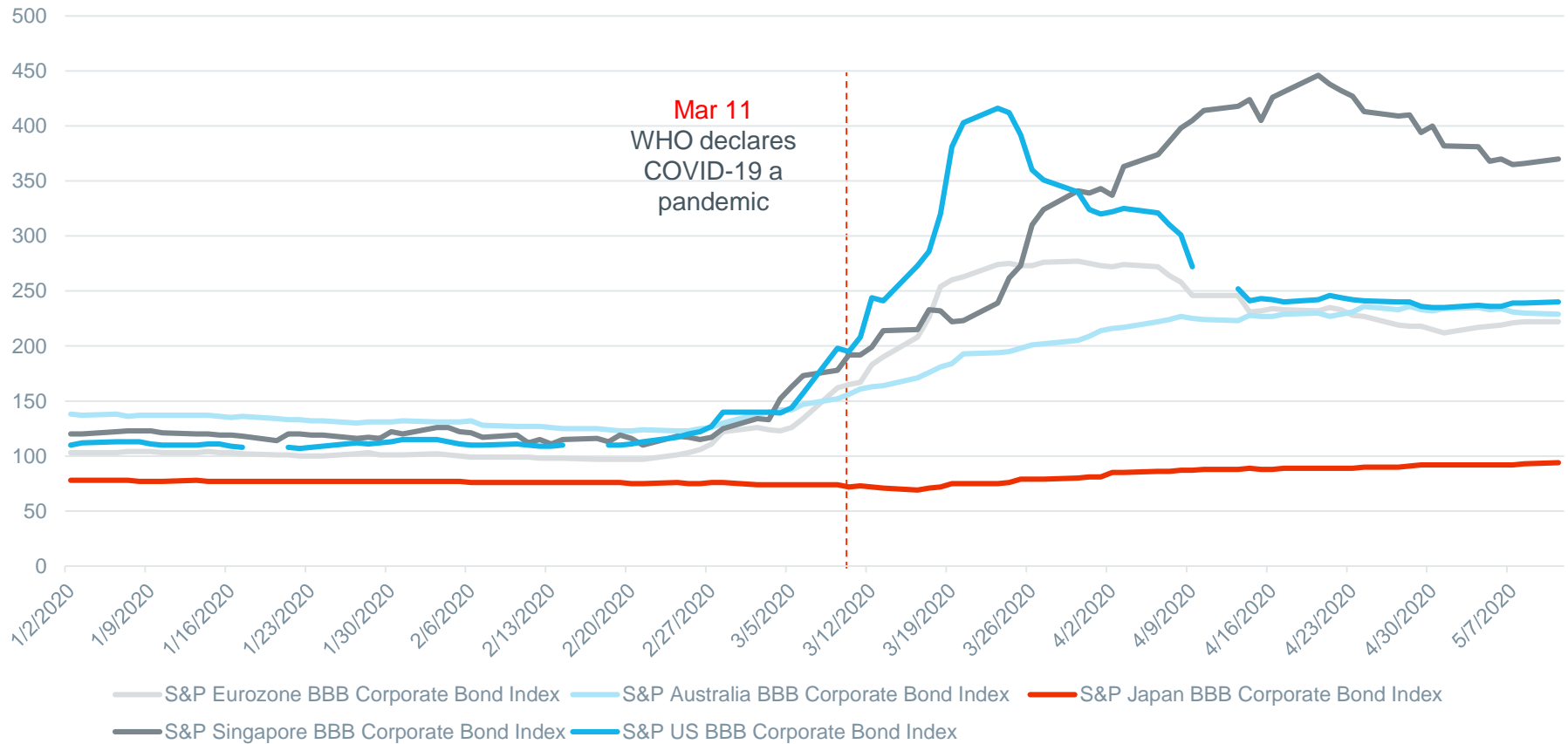
BBB Corporate Bond Yields (Source: S&P Dow Jones Indices)





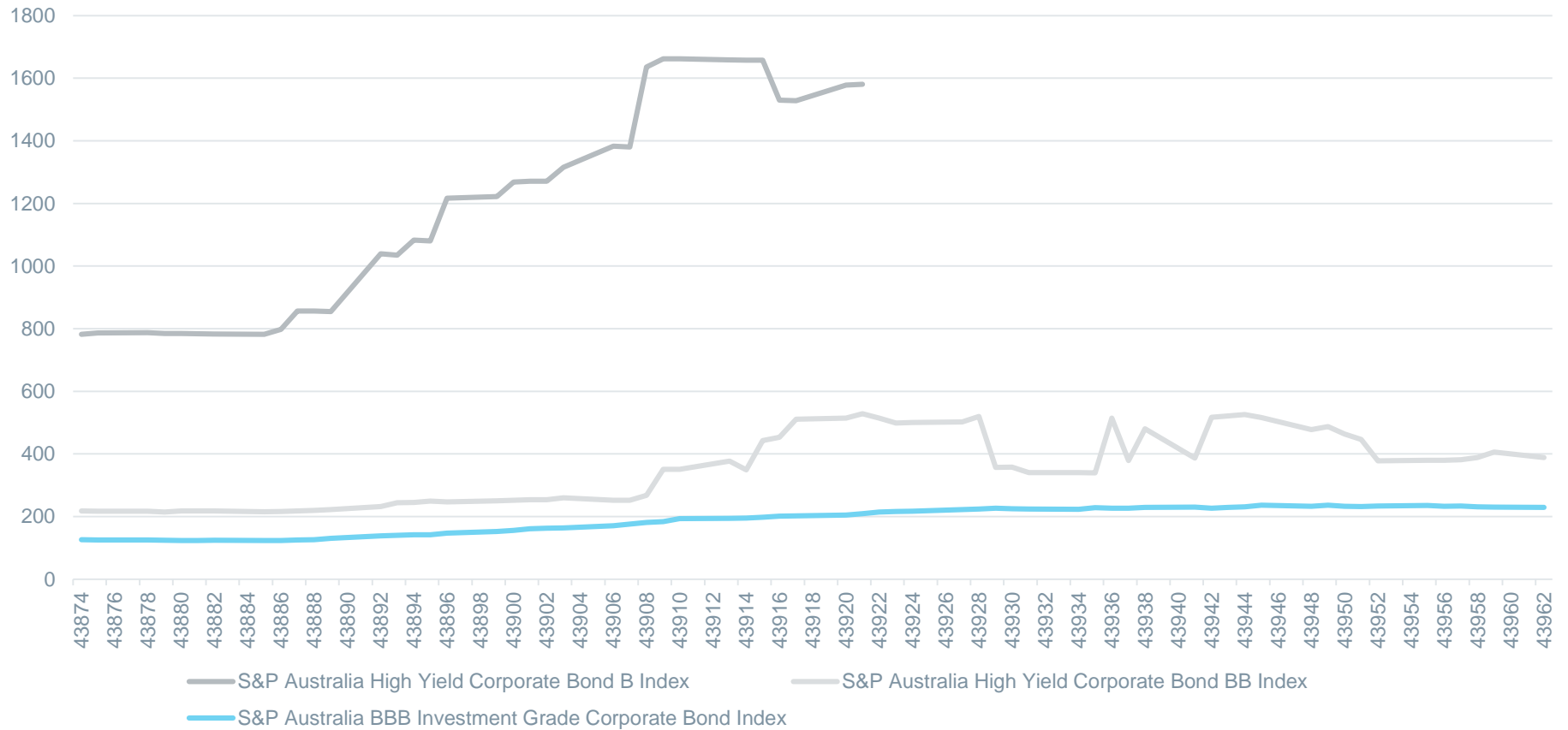
# Direction of Credit Markets

## BBB Corporate Bond Spreads (bps)



# Impact on Creditworthiness

## AUD Investment vs Non-investment Grade Spreads (bps)



# Impact on Loan Terms and Conditions

Term	Considerations
Type of Instrument	<ul style="list-style-type: none"><li>• Term loan</li><li>• Revolving credit facility</li><li>• Hybrid / RPS: Accounting benefits, covenant lite, discretionary payment of interest, non-cumulative, deferrable interest</li><li>• Cash pool</li></ul>
Amount / Capital Structure	<ul style="list-style-type: none"><li>• Overall funding requirements</li><li>• Appropriate funding mix (debt vs equity)</li><li>• Financial covenants</li><li>• Thin capitalisation</li><li>• Restructure of existing intercompany financing?</li></ul>
Tenor / Maturity	<ul style="list-style-type: none"><li>• Purpose of the funding: long term investment vs. meeting short term working capital requirements</li><li>• Extension of maturity?</li><li>• Shift in trade credit – should any growth in trade payable balances beyond normal terms incur interest?</li></ul>
Currency	<ul style="list-style-type: none"><li>• Availability of funding in a given currency for the borrower and lender</li><li>• Currency of third party funding, if any</li><li>• Ability for borrower to create a natural hedge</li><li>• FX hedging policy</li><li>• WHT benefit in relation to FX swaps?</li></ul>

# Impact on Loan Terms and Conditions

Term	Considerations
Seniority / Ranking	<ul style="list-style-type: none"><li>• Existence of senior debt</li><li>• Ability to obtain senior debt funding exhausted?</li><li>• Evidence of second lien bank debt in the industry</li></ul>
Early Repayment / Prepayment Clause	<ul style="list-style-type: none"><li>• Need for flexibility for the borrower or lender</li><li>• Avoid being locked in to a high interest rate or too high debt amount over time</li><li>• Need to monitor regularly if option should be exercised</li></ul>
Interest Deferral	<ul style="list-style-type: none"><li>• Evidence of interest deferral by banks to preserve principal</li></ul>
Security	<ul style="list-style-type: none"><li>• Collateral pledges</li><li>• Evidence of unsecured financing between third parties</li></ul>
Guarantee	<ul style="list-style-type: none"><li>• Ability of the borrower to attract funds on a standalone basis without parental guarantee</li><li>• Character of the guarantee, i.e. pricing benefit or substitution of capital</li><li>• Impact of implicit support</li><li>• Pricing of the guarantee</li></ul>

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## Tax Administration: Near-term impacts on APAs, MAP, litigation, audits and documentation deadlines



## OECD coordination of tax policy responses

- OECD issued guidance to tax authorities
- Range of targeted and temporary measures intended to help keep households and businesses afloat during the pandemic
- Suggested measures include:
  - Extension of tax return and tax payment deadlines
  - Deferral of tax payments
  - Penalty and interest remission
  - Debt payment plans and suspending debt recovery
  - Early tax filings and quicker refunds
  - Providing early tax certainty where appropriate
  - Deferring audit activity (other than in cases of fraud)

## Tax administration impact

- Countries have reacted to the economic impact of COVID-19 with a variety of stimulus measures designed to support businesses and households, and preserve employment
- Tax administrations are having to adapt to the situation and reassigning resources to focus on implementing economic stimulus
- Temporary suspension of day-to-day investigation and compliance assurance activities
- Non-critical matters are being deferred and delays are to be anticipated
- Transfer pricing matters also impacted

## APAs and tax rulings

- Ongoing APA negotiations and new applications for rulings are likely to be deferred in most countries
- Some tax authorities have stated they will help companies to deal with the impacts of the crisis on existing APAs
- Taxpayers may find that the market and economic conditions impact the critical assumptions of their tax rulings
- Affected taxpayers should be monitoring their critical assumption compliance and taking the appropriate actions



## Permanent Establishments and place of management

- Many employees are now working from home and unable to travel to their normal place of work, even dislocated to countries other than their regular country of work, triggering fears of creating PE and/or corporate residency risks for businesses
- The OECD issued emergency guidance to address the dislocations, emphasizing requirement of permanence for a PE
- Many governments have issued specific assurances including Australia, NZ and Singapore in Asia Pacific. Others likely to follow OECD guidance

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# Tax Administration

## Tax payment deferral

- The most common type of tax measure to enhance business cash flow among countries has been the deferral of tax payments
- Most countries have introduced deferrals for certain tax payments

## Tax filing deferral

- Many countries have also introduced measures to provide business taxpayers with additional time to file tax returns

Each country has specific deferral rules – different taxes and different categories of taxpayers

## Other tax measures for supporting businesses

- Customs measures
- Loss carry-forwards and loss-carry-backs
- Accelerated of tax refunds and/or more flexible tax repayment plans
- CbC filing extensions
- Remittance of penalties and interest for late filing of tax returns or for late tax payments

## The COVID-19 experience ... the epilogue

- COVID-19 will end ...
- Governments will have massive debts and will need to replenish their coffers
- Multinationals are often the easiest target politically
- COVID-19 does not alleviate taxpayers statutory obligations to file arm's length tax returns and comply with the arm's length principle
- Taxpayers must document their COVID-19 decisions taken, contemporaneously
- Taxpayers must document their specific COVID-19 experiences from a transfer pricing perspective

## Key country policy responses

- Details of governmental responses to the COVID-19 pandemic are perhaps most easily accessed here:
  - » <http://www.oecd.org/coronavirus/en/>

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# COVID-19 Resources

## OECD COVID-19 Landing Page

[www.oecd.org/coronavirus/en/](http://www.oecd.org/coronavirus/en/)

## Duff & Phelps COVID-19 Resource Center

[www.duffandphelps.com/coronavirus-COVID-19-managing-risks-organization](http://www.duffandphelps.com/coronavirus-COVID-19-managing-risks-organization)

## Kroll COVID-19 Heat Map

[www.kroll.com/en/COVID-19-heat-map](http://www.kroll.com/en/COVID-19-heat-map)

## Duff & Phelps Cost of Capital

Navigator [www.dpcostofcapital.com](http://www.dpcostofcapital.com)

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# Douglas Fone

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Douglas Fone joined Duff & Phelps in May 2017 from Quanterra Global. He is a managing director in the transfer pricing practice based in Singapore, with extensive transfer pricing experience throughout south-east Asia and Australia. Douglas has provided transfer pricing advice to many multinational clients throughout the region, covering design of transfer pricing systems; preparation of Masterfile/local file documentation; negotiation and conclusion of unilateral/bilateral APAs; and successful management of complex transfer pricing audits.

Douglas's experience covers a wide range of industries, including construction and engineering, mining, trading, logistics, consumer electronics, automotive, BPO and shared service centers. He is a regular presenter at regional conferences and has been named as one of the world's leading transfer pricing professionals by Legal Media Group.

Prior to joining Duff & Phelps, Douglas was managing director and co-founder of Quanterra Global. Before Quanterra Global, he was a director in the transfer pricing group of PricewaterhouseCoopers (PwC) in Sydney, Australia, and previously worked in the Singapore and Hong Kong offices of PwC dealing with the international tax, M&A and transfer pricing issues for multinational clients in the Asia-Pacific region.

Douglas is a UK-qualified Chartered Accountant (ICAEW) and has a Bachelor of Laws (LL.B) from King's College London.

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David retired as a partner of EY in 2013 and has over 27 years international tax and transfer pricing experience, covering most industries however, but with a particular interest in natural resources and technology. He has very specific experience with intellectual property. His technical experience covers international tax, transfer pricing and tax effective supply chain. David has experience working in three major jurisdictions being Australia, the United States and the United Kingdom (where he last served with EY). David built and led the National Transfer Pricing Practice of EY in Australia over many years prior to his move to the UK, where he also led the UK transfer pricing practice of EY.

Since returning to Australia David established his own transfer pricing practice prior to joining Duff & Phelps. He continues to specialise in intellectual property planning especially for outbound Australian companies. David also acts as an expert witness in transfer pricing litigation.

David is an innovative thinker with immense practical and commercial experience in tax and transfer pricing and can solve your most complex issues. David prides himself on high quality, but practical advice to his clients.

He is a Fellow of the Institute of Chartered Accountants in Australia and New Zealand.



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George Condoleon joined Duff & Phelps in May 2017 from Quanterra Global. He is a Director in the transfer pricing practice based in Sydney and leads the financial services and financial transactions practice in Asia.

George has over 20 years experience in advising multinational companies on their transfer pricing compliance, structuring of cross-border trade and complex transfer pricing disputes, with a focus on financial transactions/treasury activities and the financial services industry, including banking and capital markets, asset management and insurance.

Previously, George was a Director in the transfer pricing group of PricewaterhouseCoopers in Australia. During this time he had a one-year secondment to a leading financial services institution in Paris, France.

George holds a Bachelor of Economics with Honours from the University of New South Wales.

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# Steane Hainsworth

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Steane Hainsworth joined Duff & Phelps in May 2017 from Quanterra Global. He is a director in the transfer pricing practice based in Brisbane, Australia. Steane has over 25 years of legal and tax experience, specializing in transfer pricing. He has advised numerous clients across a wide range of industries in relation to transfer pricing risk management and compliance strategies, the design of transfer pricing models and has managed transfer pricing reviews, inquiries and audits across a number of different countries.

Previously, Steane was a Partner at Quanterra Global, the Asian transfer pricing leader for Crowe Horwath International, and worked as a senior transfer pricing specialist for Big 4 firms in New Zealand, Canada and Australia. He started his career with the Inland Revenue Department in New Zealand.

Steane is the author of a number of transfer pricing articles and a regular speaker on transfer pricing matters at seminars in Australasia, South-East Asia, North America and Europe.

Steane holds a Bachelor of Laws from Victoria University of Wellington and is a Barrister and Solicitor of the High Court of New Zealand. Steane is a registered tax agent in Australia and is a member of the Tax Institute of Australia.