

# Evaluating changes in transfer pricing positions in an economic downturn: a COVID-19 scenario

There are exceptional circumstances that could cause businesses to deviate from their transfer pricing policies. The downturn in both the global and Nigerian economies due to the impact of COVID-19 will have serious implications for many multinational businesses operating in Nigeria, especially in the areas of transfer pricing policy implementation and documentation.

Predictably, businesses in Nigeria have been affected by the COVID-19 pandemic as economic activities in the country have reduced significantly since March 2020, when a temporary shutdown of the economy was announced by the Federal Government to curtail the spread of the virus. The tax authorities will, in the future, require businesses that are adversely affected by COVID-19 to explain losses or decreased profits for the relevant years. It is, therefore, necessary for businesses to start examining the impact of COVID-19 on various aspects of their operations in order to show that the transfer prices adopted and other transactional and commercial decisions taken were in line with the arm's length principle.

Presently and in the immediate future, businesses may need to take certain measures in some key areas of their operations that may have been impacted by COVID-19. This will help to manage their cash tax payments, protect bottom line and mitigate the economic impact of COVID-19.

The measures that may be considered by businesses, from a transfer pricing perspective, include:

- Change in supply chain**  
 COVID-19 has caused substantial disruption in the global supply chain. These may be accompanied by changes in existing functional and risk profiles of various group entities, which will necessitate a realignment of the value chains and as a consequence, impact costs and margins on transfer



## The change in economic circumstances due to the impact of COVID-19 must be appropriately documented for transfer pricing purposes.

pricing. The change in supply chain may also lead to business restructuring and creation of intangibles in certain industries (e.g. e-commerce/digital businesses). The long-term effect of COVID-19 in these industries may pose challenges in valuing the intangibles.

Multinational groups may need to review actual conditions and the ability to fulfil performance obligations under existing agreements across jurisdictions. They may also consider re-allocating profits to reflect economic re-allocation of functions, assets and risks based on current economic circumstances.

- Intercompany financing**  
 Businesses may have to develop a substantive plan for cash management as part of their overall business risk and continuity programs. The current environment may require (or present opportunities for) businesses to restructure financing transactions and other treasury operations.

In implementing the transfer pricing aspects of their financing, businesses may need to consider certain factors. These include potential exposure to greater financial

risks by depositors in a cash pool where either the creditworthiness of the borrowing entity or parental guarantee becomes less valuable, widened spread or increased interest rates on certain instruments to reflect latest market fundamentals, sustainability of new loans by borrowers in the current climate etc.

- Royalty and technical service fee payments**  
 It may become more difficult to support payments of royalty and technical fees to group entities that report substantial returns while the paying companies are in loss-making positions. This could change the arm's length pricing of intellectual properties/brand or technical services, thereby necessitating a temporary suspension of royalty and technical service fee payments, especially where the arrangements are not protected by relevant safe harbour provisions in the domestic transfer pricing rules.

Suspension of royalty and technical service fee payments may potentially help multinational groups to preserve their cash reserves by avoiding cash tax payments through

withholding tax savings.

- Remuneration for routine services**  
 Certain routine services provided during the COVID-19 pandemic may not pass the benefits test and therefore, remuneration for these services may not be accepted as a deduction by the tax authorities of the paying jurisdictions. The multinational groups may consider suspending remuneration for routine services. They may also reduce the remuneration by setting a new one at a point within the lower quartile of a benchmark range.

In addition to the above measures, businesses may consider reviewing existing intercompany agreements to analyse if changes in transfer pricing need to be made in such agreements (e.g. possible renegotiation of short term financing to long term and the related interest rates due to longer cash cycles). Also, businesses may consider invoking "force majeure" clause where certain contractual obligations cannot be fulfilled or "hardship" clause where there is an unforeseeable event that disrupts the economic balance of intercompany agreements. Activating

these clauses will help businesses limit or mitigate potential transfer pricing consequences, if they exist in the agreements.

Also, intercompany agreements may have to be renegotiated based on current economic realities and practices by third parties, which may not reflect the existing transfer pricing policies. Where a force majeure or hardship clause does not exist, businesses may agree in writing with their contracting associates to renegotiate existing agreements in the immediate future based on the exceptional economic circumstances when the impact of COVID-19 pandemic has become clear and quantifiable.

### Conclusion

The change in economic circumstances due to the impact of COVID-19 must be appropriately documented for transfer pricing purposes. This will enable taxpayers to support their transfer pricing positions and the commercial rationale for deviating from existing transfer pricing policies for future tax audits, especially where they are expected to make losses or lower profits.

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