

Global Tax Alert

News from Transfer Pricing

Australian Taxation Office publishes guidance on COVID-19 economic impacts on transfer pricing arrangements and altering related party arrangement

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Executive summary

On 19 June 2020, the Australian Taxation Office (ATO) published new web guidance regarding the COVID-19 economic impacts on transfer pricing arrangements ([link](#)); and in a separate publication expressed concerns regarding businesses altering related party arrangements ([link](#)) to trigger deductions, reduce withholding tax, depress assessable income or assume global losses. Accordingly, altering transfer pricing positions and related party agreements may trigger significant ATO review and compliance activities.

This Alert summarizes the ATO's guidance.

Detailed discussion

COVID-19 economic impacts on transfer pricing

With the effects of COVID-19 on the Australian economy not yet known or quantifiable, as well as the varied impacts on specific industries and businesses, the ATO is not currently seeking to review *PCG 2019/1 Transfer pricing issues related to inbound distribution arrangements*. Instead the ATO will assess the facts and individual circumstances to understand changes and will focus on financial outcomes achievable without the impact of COVID-19.

“This analysis may include:

- ▶ *a detailed profit and loss analysis showing changes in revenue and expenses, with an explanation for variances resulting from COVID-19 – this may include a variance analysis of budgeted (pre-COVID) versus actual results*
- ▶ *details of profitability adjusted to where your outcome would have been if COVID-19 had not occurred – this should consider all factors that have a positive or negative impact on your profits and should be supported by evidence*
- ▶ *the rationale and evidence for any increased allocation of costs or a reduction of sales (and subsequent changes in operating margins) to the Australian entity, taking into consideration its function, asset and risk profile*
- ▶ *evidence of any government assistance provided or affecting the Australian operations.”*

Taxpayers with an advance pricing arrangement (APA) expecting a breach of the critical assumptions in an existing APA are expected to seek active engagement as part of which the ATO may consider: *“business as usual, renegotiating the APA over the time period of the demonstrable impact, or suspending or modifying the APA for a set period.”* An APA application not yet concluded may be difficult to progress further where a business is significantly affected by COVID-19.

ATO concern regarding altering related party agreements

The ATO is [aware of certain activities](#) by businesses with related party arrangements seeking the following tax outcomes:

- ▶ *“Triggering tax deductions for foreign exchange losses by early termination or repayment of liabilities under related party financing agreements.*
- ▶ *Avoiding ongoing withholding obligations on amounts payable to overseas parties by changing related party agreements.*

- ▶ *Reducing assessable income from rights or property provided to overseas related parties by changing related party agreements.*
- ▶ *Increasing contractually assumed risks and allocation of global economic losses for limited risk entities by changing related party agreements.”*

The ATO will consider what independent parties would have agreed to in the circumstances and the substance of the actual dealings as well as the application of the dominant purpose test and the diverted profits tax in the general anti-avoidance regime. The ATO will also be interested in whether the changes and associated commercial justification originated with a tax adviser.

Further, the ATO has indicated in recent engagements that businesses that have or are considering changes to related party arrangements are encouraged to proactively engage with the ATO. Any changes to related party arrangements will need to satisfy the arm's length conditions test in Subdivisions 815-B to D of the *Income Tax Assessment Act 1997*. It is possible that COVID-19 may result in changes to the conditions agreed in third party arrangements, some of which might be reasonably expected to be imported into related party arrangements. Where this is the case, it will be important to gather and record evidence to support any changes to, or impacts on, the business as a result of COVID-19. It also is fundamentally important that the right people in an organization are overseeing the decision-making process and any changes should not be driven by the tax function. Businesses will reposition themselves for various reasons, but any strategic change will involve working through the options realistically available and choosing the option that reflects the economic interests of the businesses.

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