



## Tax Newsletter

Timely news and information on national tax issues

### Main strategies to be implemented in response to the COVID-19 impacts, on Transfer Pricing matters

Currently, the business world is experiencing a time of great uncertainty. The diverse public policy measures that have been implemented to contain the spread of COVID-19 have resulted in many different general economic problems, and consequently, varying impacts at the operations level of various industries.

A large number of companies, at both the local and international levels, are facing unfavorable commercial and market conditions. This will of course lead to decreases in their ordinary revenues due to the sudden drop in demand. In many cases, this decrease in income will result in permanent operating losses, as well as significant reductions in their working capital and liquidity.

In economic terms, most sectors and industries have reported a significant drop in their contributions to real GDP, and in fact, some equity analysts have assumed that there will be a decline in business earnings of nearly 30%.

Given this unfavorable outlook, it is important to analyze how flexible the Transfer Pricing structure is in the different MNE Groups. This diagnosis requires the evaluation of four relevant elements that could limit the handling of the current situation:

1. Analysis of the actual impact on the taxpayer's industry and/or sector. This implies determining the specific impacts on the industry and knowing how the taxpayer has been interacting with its clients and suppliers.

2. Applicable legal framework. The local rules and various measures implemented in each country are very unique and may limit the available options.
3. Analysis of the current intercompany agreements. This implies a necessary review of the contractual clauses and verification of exceptions, limitations and flexibility.
4. Analysis of their own actions. In this respect, it is necessary to verify the functions and risks assumed by the different companies of the MNE Group. Based on the above, this type of analysis could allow for proactively and fairly adjusting or renegotiating Transfer Prices. In regard to this point, the MNE Group could choose measures such as:
  - a) New types of transactions;
  - b) Elimination of intercompany transactions (review of Benefit Test);
  - c) Alignment of the value chain or business cycle;
  - d) Reallocation of functions;
  - e) Relocation of intangible assets or Intellectual Property (IP);
  - f) Repatriating of cash, etc.

### Possible responses to COVID-19

In Transfer Pricing matters, the main tool used by taxpayers and tax authorities for demonstrating compliance with the arm's length principle or market value is making a comparative analysis, using the interquartile range as a statistical measurement.

This comparability analysis requires the compiling of a variety of data on the entities, such as prices or profits.

Currently, most of the comparability analyses used by taxpayers consider the Transfer Pricing methods that are based on the profits of comparable companies. Therefore, it will be necessary to apply different strategies in response to the different economic, financial and restructuring impacts on the local taxpayers and/or the companies used as comparables.

Following, we refer to some of the possible responses to the impacts of COVID 19:

1. **Change the Transfer Pricing method.** It is necessary to verify whether a method based on operating profits (for example, TNMM) would be the most appropriate given a situation of operating losses. There could be companies where the impact of COVID-19 has been substantial enough to justify the change in method, but in any event, part of this justification could require evidence of situations not controlled by the taxpayer (i.e. increase in purchase prices, drop in demand, etc.).

Based on the above, it would be possible to consider a method based on the division of profits (Profit Split).

Within this strategy, taxpayers could also consider the possibility of changing from a pre-established profit margin (*fixed markup*) to a profit margin that adheres to the arm's length principle (*variable markup*).

2. **Segment the specific cost due to COVID-19.** It is important to isolate the specific costs or expenses related to the pandemic, mainly if these types of expenses were not assumed by the companies selected as comparable.

It is very likely that upon making the Transfer Pricing analysis at the closing of the 2020 fiscal year, the tested party (for example, the local taxpayer) will have financial statements affected by costs or expenses resulting from COVID-19. However, the situation could be different for the comparable companies in that the information available as of the date of the evaluation comes from different fiscal years (2019-2017). In other words, it corresponds to historical financial information that does not reflect the same economic conditions of the tested party.

3. **Establish a specific range for COVID-19.** In this respect, it is necessary to consider aspects such as:
  - a) Extending the search for comparable companies; that is, adding other considerations to the selection criteria used, such as, the use of comparable companies facing difficulties or adverse situations,

extending the search to similar industries with operating leverage etc., similar to the tested party.

b) Adding more years of comparative data. In some jurisdictions, Transfer Pricing regulations refer to the years of comparison to be used in the comparability analysis, for example, 1vs1, 1vs3, 3vs3. However, in the case of El Salvador, the local regulations do not make explicit reference to this type of consideration, and therefore it would be necessary to assess the strategy for making the most reasonable comparison based on the circumstances.

c) Performing a detailed analysis of the financial information of the potentially comparable companies in order to adapt it to the impacts caused by COVID-19. This implies improving the comparability criteria and/or adjusting the possible differences.

#### 4. Anticipate changes in your existing market ranges.

The preliminary analysis becomes more relevant since this would allow for determining whether many of the comparable companies selected in previous years still have publicly available information and/or have any market share. Finally, it is necessary to analyze how the selected comparables look with financial data from the 2020 fiscal year, in order to verify the possible changes in the market ranges.

#### Final comments

According to the information presented in this document, it is necessary for taxpayers to develop a framework of reference that allows for adequately evaluating entities affected by COVID-19 within the structure of the MNE Group: Parent Company, Service Companies, IP Companies and Operating Entities.

The strategies to be implemented should in particular be adapted to each of the cases. However, it is recommended that taxpayers document the reasons for the application of any strategy and evaluate the Transfer Pricing regulatory framework in each of the jurisdictions in order to align the tax position with the business objectives.

Certain strategies may imply the creation of new intercompany transactions, such as intergroup services, financing (new intercompany debt), etc. For these types of strategies, a particular Transfer Pricing analysis is required, whose objective is to determine the price of the transactions in compliance with the arm's length principle.

Finally, for each of the strategies to be implemented, taxpayers should separately assess the possible tax effects that such strategies may have, in terms of the Income Tax, withholdings, and indirect taxes.



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# Tax Calendar

## June 2020

The updated 2020 tax calendar is now available on the Tax Administration’s website, which includes the public holidays and the deadlines for all tax obligations.

S	M	T	W	T	F	S
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30				

**Download our  
2020 Obligations Calendar**

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**June 12**

**VAT**

Declaration and payment of the Tax on the Transfer of Movable Goods and the Rendering of Services (F-07).

**Financial Income and Transactions**

Monthly declaration of Payment on Account, and Tax Withheld on Income, Financial Transactions, and the Special Contribution for Citizen Security and Coexistence (F-14)

**Specific and Ad-valorem**

Declaration and payment of Specific Taxes, Ad Valorem Taxes and Special Contribution (F-06).

**Other Obligations**

- Report on Donations (F-960)

- Report on Specific and Ad Valorem Taxes on Producers and Importers of Alcoholic Beverages, Potable Ethyl Alcohol and Beer, Carbonated Beverages, Isotonic Beverages, Fortified Beverages or Energy Drinks, Juices, Nectars, Soft Drinks and Concentrated or Powder Mixtures for the Preparation of Drinks (F-955).
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Firearms, Ammunitions, Explosives and Similar Items, Producers of Tobacco and Producers, Importers and those that clear fuels through customs (F-988)
- Monthly Report of Sales to Producers, Distributors or Retailers of Tobacco and Tobacco Products (F-956)
- Statement of Origin and Application of Funds (F-950).

**June 22**

**VAT**

Monthly Report on Withholdings, Collections, or Payments on Account of VAT (F-930).

Report on Authorizations Made to Accounting Systems (F-463).

**June 29**

Monthly Report on Withholdings, Collections, or Payments on Account of VAT (F-930)

**June 30**

Income Tax Return and Declaration of Special Contribution by Large Taxpayers to the Citizen Security Plan for the 2019 Period (F-11)

Report on Capital Gains and/or Losses 2019 Period (F-944)

Declaration of Real Property 2019 Period (F-30)

**June 17**

Father’s Day.

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