

April 2020

TRANSFER PRICING in the face of the economic crisis

The uncertain situation in the economic market caused by the outbreak of the COVID-19 epidemic may cause many difficulties for companies operating in Poland. From a tax perspective, transfer pricing is one of the areas that should be kept under particular scrutiny by Polish companies belonging to international capital groups at this time. Depending on the industry in which the group operates, the effects of the upcoming economic crisis may prove to be severe. This in turn may result in mutual settlements between related parties belonging to a given group as well as documentation and information obligations in the area of transfer pricing.


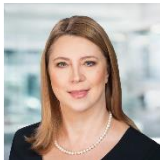

Below we present the issues which, in times of economic slowdown, require analysis from the perspective of Polish companies settling accounts with related parties:

Settlement model (including the company's functional profile)

An area that raises many questions about the impact of the epidemic on intergroup settlements is the possibility of changing the current transfer pricing policy and the methods of calculation and the level of applied prices established therein. Assuming the unchanged scope and manner of execution of intra-group transactions, any changes in the calculation methods and/or price level should first be considered from the perspective of the distribution of risks between entities in connection with their operations and transactions. The structures where Polish entities operate as entities bearing limited risk require particularly thorough analysis. The functional profile of a company (manufacturer or distributor) defined in this way raises questions whether the profitability level guaranteed so far may change or whether such an entity may incur a loss (participate in group losses) in the situation of a market collapse. In order to determine the possibility of introducing changes to the current transfer pricing policy, it is necessary to analyze the settlement models and agreements that have been functioning within the capital group so far. The issue of intergroup settlements is also important from the perspective of the analysis of the legitimacy of making adjustments to the settlements even before the end of the financial year.

Benchmarking

Another issue important for Polish entities from the perspective of both current intra-group settlements and drafting transfer pricing documentation for 2020 is benchmarking. Benchmarks are an obligatory element of local documentation and are used to determine the market level of remuneration of the analyzed company. In accordance with transfer pricing regulations, benchmarks should be updated at least every three years, unless a change in the economic environment which considerably affects the prepared analysis justifies an update in the year of the change. This is likely to be the case this year. Therefore, due to the expected major change in the market situation for most industries, it will be necessary to update benchmarks, even if the period of 3 years has not passed since they were prepared. Unfortunately, it should be noted that in the case of benchmarks prepared on the basis of external databases, market comparative data necessary for updating, reflecting current market conditions, will be available at the earliest at the end of 2021 and in 2022. Thus, it will be possible to perform a traditional benchmark neither in 2020 nor – in the case of most entities – before the deadline for drawing up local transfer pricing documentation for 2020. Therefore, it will be necessary to estimate the impact of the downturn on the previously established market price/profit level in a different way. In a situation where benchmarking cannot be carried out with due diligence, the legislation allows for the determination and justification of the market price level by means of the so-called compliance analysis showing under what conditions a controlled transaction would be carried out between unrelated parties in a given situation.

Management statement and TPR form	<p>An important issue, resulting from the aforementioned issues, will also be the signing by the management board of a statement on having drawn up local transfer pricing documentation for 2020. It should be remembered that Polish transfer pricing regulations, applicable to tax years commencing after January 1, 2019, introduce a new element of the statement. From now on, the management of the entity must sign a statement that the prices in transactions with related parties are marketable. Therefore, in order to make sure that these transactions are carried out in 2020 on an arm's length basis, it is important to analyze and adjust the benchmarking studies accordingly.</p> <p>The aforementioned regulations require the taxpayer to prepare a TPR form as well, in which the prices/performance of the entity will be presented, broken down into concluded transactions and referred to the benchmarking results. Therefore, it is also important to develop an appropriate approach to updating benchmarks and correctly determine the market level of remuneration in the context of preparing the TPR form.</p>
Advance pricing agreement	<p>The impact of the economic crisis may also be relevant for taxpayers who have entered into an advance pricing agreement with the tax authority. The agreement is based on benchmarks and critical assumptions, which may prove difficult to meet in an economic downturn. Therefore, also in this case, it will be necessary to verify the agreed assumptions and possibly renegotiate the arrangements with the Head of the National Revenue Administration (KAS).</p>
Tax audits in the area of transfer pricing	<p>Recently, we have observed a great interest of tax authorities in transfer pricing issues. Tax audits in this area are conducted regularly. Due to many aspects related to transfer pricing during the economic crisis (the aforementioned issues related to intra-group settlement models, benchmarking, or the management board's statement), a further increase in the number of audits of transactions with related parties can be expected. As a result, adequate steps in these areas should be taken as soon as possible to meet the formal requirements set out in Polish transfer pricing regulations.</p>
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