

## Responses to practical questions on the Transfer Pricing implications of the COVID-19 impacts

On 30 September 2021, the China State Taxation Administration responded to five hot questions regarding the Transfer Pricing implications of the COVID-19 impacts:

- **Focus of the Transfer Pricing investigation**

During the pandemic period, many enterprises have faced the impacts of the virus. However, the extent to which various industries are affected by the pandemic differs drastically— while it posed huge challenges for some of the industries, it also brought new opportunities to others. Tax authorities will follow the arm's-length principle during the Transfer Pricing investigation in light of the impact of the pandemic on intercompany transactions.

- **Losses of the COVID-19 pandemic**

When evaluating the impact of the pandemic, tax authorities will consider all relevant factors, such as function and risk profile, characteristics of intercompany transactions, characteristics of the industry to which the enterprise belongs, and situations of its comparable entities etc.

Regarding the additional operation costs incurred due to the pandemic, tax authorities will consider an adjustment on costs for differences between intercompany transactions and third-party transactions. Companies are recommended to prepare a detailed and quantitative analysis of incurred losses and maintain supporting documents for potential inspection in the future.

- **Sizable fluctuation of profit level**

In 2020, the profitability of many companies fluctuated significantly due to the pandemic. In the local TP file, companies should explain in detail about the impact of the pandemic on intercompany transactions, the value chain and industry etc. Furthermore, in comparable analysis, companies should focus on the multi-dimensional data of comparable entities so that the benchmark result can reflect the impact of COVID-19 on the profit level of the industry.

- **Government assistance**

2020 saw the Chinese government offer a series of relief measures to companies, which needs to be considered in the TP file preparation, particularly in the comparable analysis. Where arrangements on Transfer Pricing are affected by government assistance, companies should provide relevant information and supporting analysis in the local TP file. Tax authorities should identify comparable factors to ensure the fairness and consistency of the benchmarking result.

- **Advance pricing agreement**

If the changes due to the pandemic have affected the application of existing APA, companies should prepare documents to explain to tax authorities the specific changes induced by the pandemic and negotiate with them on how to deal with and respond to these changes in terms of implementing arrangements on advance pricing. Tax authorities will evaluate the extent of the changes. The APA might be cancelled or revised based on further negotiation.

The China State Taxation Administration provided the above principles which companies and tax authorities could follow when dealing with the Transfer Pricing implications of the COVID-19 pandemic. In the TP work for year 2020, the impact of COVID-19 should be fully considered and analyzed to ensure the reliability and accuracy of the TP reports.