



Tax Newsletter

Timely news and information on national tax issues

Aspects Salvadorian taxpayers should consider in their TP analysis based on the transfer pricing implications of COVID-19 indicated in the guidance published by the OECD

The 2020 fiscal year was atypical due to the COVID-19 pandemic, which affected different aspects around the globe, including of course the economic environment. During this period, many companies throughout the world encountered significant limitations, such as, cash flow constraints, disrupted or halted supply chains, reduced operations/production, and in some cases, even changes in how they conduct their business.

Likewise, the policies and restrictions imposed by governments for controlling the pandemic affected the performance of companies' business operations. Consequently, the economic impact faced by

taxpayers (or that they continue to face) was significant; in some industries more than in others. With this in mind, in any transfer pricing (TP) analysis that considers the implications of the COVID-19 pandemic, companies should try to document how and to what extent they have been affected by this pandemic.

To provide support on how to address compliance with the arm's length principle in a practical way given the situations mentioned above, the OECD has issued guidance focused on four main considerations: i. comparability analysis; ii. losses and the allocation of COVID-19 specific costs; iii. government assistance

programs; and iv. advance pricing agreements ("APAs"). Of these considerations, due to their applicability in El Salvador, only the first two will be addressed here.

Although El Salvador is not a member country of the OECD, the Salvadorian regulations consider the Guidelines issued by the OECD as an international reference on TP methodology. Therefore, it is important to take the two considerations mentioned above into account when addressing the impact of the COVID-19 pandemic on the transactions that taxpayers performed with related parties.

I. Comparability analysis

The comparability analysis, regulated in Article 199-D of the Tax Code, is a **key element when making a TP analysis**. This analysis is what determines whether a transaction performed in the market between independent parties meets the comparability requirements for establishing whether the transactions performed were agreed upon in accordance with the arm's length principle. In this respect, a change in the economic environment such as the one caused by the pandemic creates unprecedented challenges for performing a comparability analysis. These challenges may vary depending on the impact of the pandemic on the companies or on the transactions subject to analysis.

Following are some examples of information that could be useful for supporting a practical comparability analysis for the 2020 period:

1. An analysis of how sales volumes have changed during COVID-19, and specifically compared to sales generated in pre-COVID years.
2. Specific information relative to incremental or exceptional costs borne by parties to the controlled transaction (either with associated or unrelated parties).
3. Details regarding government interventions that have affected the pricing and performance of controlled transactions.

4. A comparison of internal budgeted/forecasted data relating to sales, costs and profitability, compared to actual results.

With respect to this last point, the information could contain the following items:

- a. Analysis of losses/profits showing changes in revenue and expenses, with an explanation of the resulting variances;
- b. Details of profitability, adjusted to where the outcome would have been if COVID-19 had not occurred;
- c. The rationale and evidence for any increased allocation of costs or a reduction of sales to the tested party in the controlled transaction.

Another important element in the comparability analysis is the **period being compared**. Information relating to the conditions of comparable uncontrolled transactions undertaken during the same period as the controlled transaction is the most reliable information to use in a comparability analysis. This information would provide comparable financial information, under the same economic circumstances as that of the taxpayers.

However, **the comparable financial information for the 2020 period will not be available until mid- 2021. What can be done in this case?**

The OECD suggests that the use of reasonable commercial judgment supplemented by contemporaneous information should be allowed. This implies that each taxpayer may determine the most suitable methodology for analyzing its transactions. Some alternatives that could be considered are:

1. 2020 period of the tested party compared to the 2020 period of the available comparables.
2. Comparison of multiple years (2 or 3 years), both of the tested party and the comparables; this would improve the reliability of the results obtained.

Other considerations in the comparability analysis

The OECD establishes that, in general, other considerations that could provide sufficient information for the analysis should be an option, relaxing some comparability criteria that may be normally questioned. These considerations include the following:

- Application of pricing adjustment mechanisms;
- Flexibility in the geographic comparability of the comparables;
- Allowing the use of loss-making comparables, even more so if these losses stem from the current pandemic.

II. Losses and the allocation of COVID-19 specific costs

During the COVID-19 pandemic, many multinational enterprise (MNE) groups have incurred losses due to a decrease in demand, inability to obtain or supply products or services or as a result of exceptional, non-recurring operating costs.

In general, the OECD mentions that these costs should be allocated among the members of an MNE based on the risks that each member incurs and on how independent companies would allocate such costs.

Furthermore, these exceptional costs should be taken into account when making the comparability analysis. These costs should generally be excluded from the net profit indicator, except when these costs relate to the controlled transaction. Care should be taken to ensure that these costs are appropriately measured and are consistently accounted for to the extent possible. Likewise, they should be taken into account when establishing the adjustments for consistency in the financial information to be used in the analysis.

Some examples of these COVID-19 specific or extraordinary costs are as follows:

- Expenses on Personal Protective Equipment (PPE);
- Reconfiguration of workspaces to enable physical distancing;
- IT infrastructure expenses;
- Personnel transportation expenses;
- Expenses for the allowance for doubtful accounts (in the event of lack of payment by customer); etc.

Final considerations

Given the economic circumstances brought on by COVID-19, prior to defining whether a transaction between related parties was agreed upon in accordance with the arm's length principle, it is necessary to analyze the impact that the pandemic had on taxpayers' revenue, appropriately documenting any situation demonstrating the effects in revenue, and subsequently making the corresponding adjustments.

So long as the situation can be reliably documented through a comparability analysis, the taxpayer can support their results, despite the impact that COVID-19 may have had on them.

As of the date of issuance date of this newsletter, no position has been stated by the Tax Authorities. However, we shall inform you of any developments, should they arise.



Federico Paz
Tax Partner
fepaz@deloitte.com



Alvaro Miranda
Transfer Pricing Manager
ajmiranda@deloitte.com



Mario Coyoy
Transfer Pricing Partner
mcoyoy@deloitte.com

Tax Calendar

February 2021

The updated 2021 tax calendar is now available on the Tax Administration's website, which includes public holidays and 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						

Download the 2021
Obligations Calendar



February 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)

February 19

VAT

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

Printing Presses

Monthly Report on Documents Printed for Taxpayers Registered under the VAT (F-945)

February 1

Withholding Agents

Annual Report on Income Tax Withholdings, 2020 Period (F-910).

Companies

Report on the Distribution or Capitalization of Profits, Dividends or Surpluses and/or List of

Partners, Shareholders or Members of Cooperatives 2020 (F-915).

Notaries

Report of Notaries on the Granting of Instruments in their Notarial Capacity (F-986).

Other obligations

- Request for Allocation and Authorization of Quota of Ethyl Alcohol to be Imported or Acquired (F-947).
- List of Suggested Sale Prices to the Public or Final Consumer of Unsweetened or Sweetened Soft Drinks, Isotonic Beverages or Sports Drinks, Fortified Beverages, Energy Drinks, Juices, Nectars, Beverages containing Juice, Refreshments and Concentrated or Powder Mixtures for the Preparation of Drinks; of Tobacco Products and Alcoholic Beverage Producers (F-948).
- Report on Performance of Surgeries, Operations and Medical Treatments (F-958).
- Summary of the Report on Suppliers, Customers, Creditors and Debtors (F-987).

Contacts

Federico Paz

Tax Partner

fepaz@deloitte.com

Ghendrex Garcia

Tax and BPS Partner

ggarcia@deloitte.com

Mario Coyoy

Transfer Pricing Partner

mcoyoy@deloitte.com

Cosette Fuentes

Legal Services Manager

cg.fuentes@deloitte.com

Henry Aguirre

BPS Manager

haguirre@deloitte.com

Alvaro Miranda

Transfer Pricing Manager

ajmiranda@deloitte.com

Wilmer Garcia

Transfer Pricing Manager

wsgarcia@deloitte.com

Jhonny Flores

Tax Consulting Manager

jflores@deloitte.com

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