Agenda

1. What is (the importance of) Transfer Pricing?
2. New OECD Chapter on Financial Transactions
3. Intra-group Loans
4. Cash Pooling
5. Financial Guarantee
What is Transfer Pricing?

- Transfer pricing is the pricing of controlled transactions between associated enterprises or the pricing of dealings between a Permanent Establishment and other parts of the Enterprise:
  - Provision of headquarters services
  - Allocation of bond issuance fee to group entities for services rendered
  - Provision of research and advisory services
  - Financial transactions (e.g., intra-group loan)

- The transfer price affects the taxable profits of the relevant group entities / branches

- The arm’s length principle

- OECD Transfer Pricing Guidelines
Intra-group Financial Transactions subject to Tax Controversies

- **Canada**: GE and HSBC cases on implicit support
- **Nordics**: Conoco Philips and Bombardier (cash pools)
- **Germany**: Court case intercompany loan
- **Australia**: Chevron: terms and conditions, Loan self risk assessment
- **Netherlands**: Guidance on loans and guarantees in TP Decree
- **UK**: Guidance on cash pools
- **France**: GE case implicit support
- **GSK**: Case on interest deductibility

Controversies
New OECD Transfer Pricing Guidance for Financial Transactions

OECD: Feb 11, 2020

- Accurate delineation of financial transactions by analysing the commercial and financial relations
- Regards treasury, intragroup loans, cash pooling, hedging, guarantees, and captive insurance
- The arm’s length principle can be used to recharacterize debt into equity by tax authorities, but it is acknowledged that domestic law potentially precedes
- Emphasis on options realistically available to both parties
- Application may be retroactive

- Intercompany financing transactions have been subject to multiple high-profile disputes between taxpayers and tax authorities.
- As a result the OECD and United Nations started initiatives to provide relevant guidance.
- In several countries tax authorities addressed the topic with local legislation.

- Financial institutions (regulated) are not exempted from the guidance of Chapter X
- The 2010 Report on the Attribution of Profits to Permanent Establishments of financial services business (e.g. banks) is still one of the main reference
Intra-Group Loans

After an accurately delineation analysis of financial transaction, the taxpayer should consider the following issues in determining an arm’s length interest rate for the intra-group loan:

**Credit Ratings**
- Credit ratings can be a useful measure of creditworthiness and thus help to identify potential comparables
- Commercial tools available to estimate credit rating
- Group rating versus stand-alone rating (also considering implicit support)

**Implicit Support**
- The likelihood of group members to receive group support will depend on the relative importance of the group entity to the MNE group as a whole and the linkages between the group entity and the rest of the MNE group.

**Interest Rate**
- Comparable uncontrolled price (market interest rate)
- Cost of funds
- Bank opinions generally do not provide evidence of arm’s length terms and conditions
Chevron Australia Holdings Pty Ltd v. Commissioner of Taxation

- How do you analyse whether the loan terms are at arm’s length?
- Consider external funding policies and practices of group management

Decision of Australia’s Federal Court:
- What might be reasonable expected if actual agreement had been unaffected by the lack of arm’s length dealings?
- CAHPL could have given security and covenants
- Consideration of parental guarantee
- Chevron lost appeal over a tax bill totalling $340 million covering 2004-2008 period
Treasury Function

- The treasury function is usually a support function to the main value-creating operation of the business
- However, the roles of bank treasury departments are different from those of non-financial services treasury departments. Bank treasury departments serve a highly complex and vital operational role.
Financial Guarantees

• A financial guarantee is defined as a legally binding commitment on the part of guarantor to assume a specified obligation of the guaranteed debtor if the debtor defaults on that obligation.

Explicit

• In the absence of an explicit guarantee, any expectation that other MNE group members will provide support to a related borrower will be derived from implicit support, and not as a service provision

Categories

• Borrowing capacity is increased
• Obtaining more favourable terms for borrowing entity
• To prevent “moral hazard” behaviour of parent company

Pricing Methods

• The Comparable Uncontrolled Price (CUP) method: hard to find comparable
• The yield approach: set the maximum guarantee fee
• The cost approach: set the minimum guarantee fee
Cash Pooling

Cash pooling is not undertaken regularly by independent enterprises: therefore little or no data on comparables

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<tr>
<th>Form of cash pool arrangement</th>
<th>Role of Cash Pool Leader (CPL)</th>
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<tr>
<td>Decision-making process</td>
<td>Remuneration of cash pool members</td>
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COVID-19 impact

- The terms and conditions of existing intra-group loans may need to be reconsidered and renegotiated to account for liquidity issues with potential impact on the previously agreed interest rate.
- MNEs are likely to see increased transfer pricing scrutiny by local tax authorities in the post-pandemic period.
- MNE group entities may face liquidity problems and may need additional funding or at the very least extended credit facilities. Treasury companies may obtain funding from cash-rich MNE group entities or from banks and on-lend those to the relevant MNE group entities (e.g. through intercompany loans).
- Allocation of exceptional non-budgeted cost.
Key Takeaways

- Evaluate transfer pricing policy for financial transactions against new OECD guidance
- The transfer pricing analyses of financial transactions have become much more detailed
- The accurate delineation of financial transactions is key
- Group synergies caused by deliberate concerted group actions should be allocated to the group entities contributing to these synergies (e.g., cash pool benefits)
Thank you for joining

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