



# KPMG Tax Now

20 February 2020

## OECD transfer pricing guidance: Detail for Australian business

*The guidance is critical for entities that have international-related party dealings involving financial transactions, treasury services, guarantees and captive insurance arrangements.*

### Overview

A highly-anticipated transfer pricing guidance has been released, which requires taxpayers to revisit intra-group financial transactions.

The [Transfer Pricing Guidance on Financial Transactions](#), released in February 2020 by the Organisation for Economic Cooperation and Development's (OECD), details final recommendations regarding the arm's length treatment of various financial transactions among related parties.

This follows release of [the draft guidance in July 2018](#) and applies transfer pricing methods to inter-company loans, cash pools, financial guarantees, hedging transactions, and captive insurers.

The guidance is pertinent for Australia given the Australian Taxation Office's (ATO) strong focus on intra-group loans, particularly since its success in [Chevron Australia Holdings Pty Ltd v Commissioner of Taxation \[2017\] FCAFC 62](#).

The recommendations will be included into the [OECD Transfer Pricing Guidelines](#) in relevant sections and as such, will ultimately constitute relevant guidance material for both taxpayers and the ATO to consider under Australian law when undertaking a transfer pricing analysis.

The interaction of this new OECD guidance with current OECD Guidelines, which has been interpreted in a number of relevant cases either involving financial transactions or involving the potential reconstruction of terms and conditions of an agreement, such as [Glencore Investment Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia \[2019\] FCA 1432](#), will require delicate consideration.

We will discuss some of these in greater detail below.

### Debt and funding arrangements

The OECD discusses relevant factors that may be useful for determining whether part of a loan should be considered quasi-equity in nature ([p10.12](#)).

A number of these factors are consistent with the ATO's guidance contained in [TR 92/11](#). Given this publication will ultimately form relevant guidance material that must be considered by the ATO, it will be interesting to see how these factors influence the ATO's long-awaited (and yet to be released) [Schedule 3 to Practical Compliance Guidance PCG 2017/4](#), which intends to outline factors for determining whether an interest-free loan between related parties could be either debt or equity in identifying the arm's length conditions.

The guidance also notes that in determining the appropriate tested transaction to consider, evidence with respect to how the MNE group operates (such as its financing policy) will be of particular relevance ([p10.16](#) and [p10.36-37](#)).

This is aligned to evidence that Australian courts have considered is relevant, and to ATO observed behaviour on current compliance matters, where the ATO will seek to understand group treasury policies and funding arrangements as a basis for deeming arm's length conditions. As such, it is important that Australian taxpayers are able to justify and support the terms of their intra-group funding arrangements in this context.

Further, the guidance notes, consistent with other language in the [OECD Guidelines](#), that independent enterprises will consider all other realistically available options available to them, and will only enter into a transaction if they see no alternative that offers a clearly more attractive opportunity to meet their commercial objectives'. Similar language is noted ([p10.58](#)) where the OECD indicates a borrower would look for the most:

*"...cost effective solution, with regard to the business strategy it has adopted."*

This language has often been interpreted in different ways by the ATO and taxpayers in recent matters, with the ATO considering this is supportive language to reconstruct terms of a debt arrangement to an option that may be cheaper. Taxpayers have often argued that the language should be considered in the context of undertaking a comparability assessment of the actual arrangement entered into (assuming the terms of existing arrangement can be evidenced to be commercially rational (per paragraph 1.122 of the OECD Guidelines).

How the ATO responds to this guidance will be interesting, particularly given the comments of [Justice Davis in the Glencore case](#) where her Honour noted that it was not open to the ATO to recast arrangements for the purpose of a comparative analysis (other than when the reconstruction provisions may apply) – refer to [paragraph 40](#) of the judgement.

It is also important to highlight that the guidance notes that both the borrower's and lender's perspective should be taken into account. This may mean greater emphasis should also be placed on the lender's alternative investment opportunities.

With respect to the [OECD five comparability factors](#), the guidance makes a number of key observations. These include the following points.

- Firstly, where a lender does not have sufficient economic substance, the guidance postulates that the lending entity will not be entitled to anything greater than a risk free return. As such, taxpayers should ensure that there is appropriate evidence supporting that relevant risk control is exercised by the lender. Such evidence could be important not only for transfer pricing purposes but for other tax provisions that may be relevant such as the diverted profits tax and the Financing Integrity measure contained in Australia's new anti-hybrid rules.
- Secondly, the guidance lists key features and attributes that taxpayers may wish to document and consider. Again, a number of these align to the ATO's guidance contained in [TR 92/11](#) and include features such as quantum, maturity, currency and whether the interest rate is floating or fixed.
- Thirdly, the guidance notes that the business strategies of the parties may be relevant, and references an example of where a merger or acquisition may result in a different debt arrangement being entered into, and a greater reliance on financial forecast data.

## Treasury functions

As a general proposition, the OECD considers that treasury services will typically be considered a 'support service' role ([p10.45](#)), which lends itself to a 'cost plus' pricing arrangement. This is particularly the case for cash pool arrangements.

The guidance acknowledges there may be instances where pricing could be based on third-party reference points and uses an example of where treasury is also responsible for raising third party/external funds.

Within the Treasury section, the guidance also discusses pricing of intra-group loans. It notes credit rating analysis will typically be useful for determining the credit risk of a borrower, and highlights that both quantitative and qualitative factors should be considered. Given the subjective evidence that is often considered for credit rating analyses (particularly with respect to qualitative factors), it highlights the need to undertake corroborative analyses where relevant.

Consistent with industry practice, the OECD suggests implicit support is a relevant factor to consider for benchmarking an intra-group loan. This is in line with the findings in the [Chevron case](#), which considers that the Australian taxpayer should not be treated as an 'orphan'. However, it is important to note that case law both in Australia and around the world have generally placed a low value on implicit support.

The comparable uncontrolled price (CUP) will typically be the most frequent method for benchmarking loans, and a (narrow) range of results may be an appropriate outcome, as outlined in the guidance. Further, for ancillary costs (such as upfront fees), care needs to be taken as to whether these are comparable for the tested transaction i.e. the tested agreement might not have such costs incurred with respect to the provision of that finance.

Beyond the CUP method, other benchmarking approaches considered include the cost of funds (albeit the guidelines do recognise that average group cost of funds is likely not an appropriate pricing reference – which may be seen by some as discounting current ATO practice), credit default swaps (CDS) and economic modelling i.e. valuations. Bank opinions/quotes are not considered a reliable source for benchmarking purposes ([p10.108](#)).

## Cash pooling

According to the guidance, careful consideration is required regarding cash pooling, including where a cash deposit should be considered as something else, for example, a long-term loan.

The OECD states that entering into a cash pool should not make the participant worse off than the realistic alternative, and if the cash pool leader is only doing coordination activities (and is not controlling or bearing key risks such as credit risk), then a routine service fee would typically apply. Further, consideration may be required as to whether the participant should benefit from any group synergies. At a practical level, this would be difficult to measure due to issues such as information availability.

## Financial guarantees

The OECD notes that the provision of a guarantee should provide a benefit to the guaranteed entity. Further, the benefit for which a guarantee fee should adjust for any implicit support.

Other key issues that should be considered, as outlined in the guidance, would include the purposes of the guarantee. For example, a guarantee to increase borrowing amount may be (to some degree) a contribution of equity. The financial capacity of the guarantor also needs to be accounted for.

A variety of options are put forward for pricing guarantees including a CUP method, yield approach, cost approach, an expected loss approach and a capital support approach.

## Captive insurance

The guidance provides ([p10.199](#)) a number of factors that may help support that a captive insurance entity is one of substance. This includes evidence of diversification and pooling of risk, the degree of regulation present and the skills and experience of the captive insurance provider.

It also highlights a number of potential pricing approaches for benchmarking captive insurance including CUPs, profitability analyses and group synergy considerations.

## Actions for Australian business

Given this new guidance will be incorporated in Australian transfer pricing law, taxpayers should revisit intra-group financial transactions to:

- validate the functional profiles of the counterparties to the relevant transaction;
- ensure that the value of implicit support (if any) is considered;
- ensure that the commercial rationale, and terms and conditions of financial transactions have been entered into appropriately and are supported through contemporaneous evidence and benchmarking; and
- that the pricing of any intra-group services connected to the financial transactions are appropriately justified, particularly if these are considered to go beyond a support service role.

# Contact us

## **Tim Keeling**

### **Partner**

KPMG Sydney

T: +61 2 9455 9853

E: [tkeeling1@kpmg.com.au](mailto:tkeeling1@kpmg.com.au)

## **Jane Rolfe**

### **Partner**

KPMG Melbourne

T: +61 3 9288 6341

E: [janerolfe@kpmg.com.au](mailto:janerolfe@kpmg.com.au)

---

## **KPMG.com/au/taxnow**

KPMG Tax Now is a digital media website that brings together industry-leading tax news, insights and more from our global network of experts.

We are passionate about providing insightful and relevant information to you regarding tax in Australia and overseas, shining the light on ideas not covered elsewhere.

Stay informed of important policy and legislation changes, and what it means to you and your business.

[Subscribe to our KPMG Tax Now website](#) to receive regular updates, access to exclusive content, receive invitations to special events and become involved in our community.

More information on KPMG Tax Now [can be found here](#).

The information contained in this document is of a general nature and is not intended to address the objectives, financial situation or needs of any particular individual or entity. It is provided for information purposes only and does not constitute, nor should it be regarded in any manner whatsoever, as advice and is not intended to influence a person in making a decision, including, if applicable, in relation to any financial product or an interest in a financial product. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To the extent permissible by law, KPMG and its associated entities shall not be liable for any errors, omissions, defects or misrepresentations in the information or for any loss or damage suffered by persons who use or rely on such information (including for reasons of negligence, negligent misstatement or otherwise).

© 2020 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation.