Pricing of intra-group financing transactions

Stora Skattedagen
Stockholm, 8:e november, 2018
Existing guidance

A central framework is needed
Consideration for BEPS

Country A

Country B

Market practice

Case Law

Local rules

December 2016

December 2016
OECD discussion process

- OECD Discussion Draft
- Comments
- Final Report
- OECD Guidelines
- Local Implementation

Jul 2018 - September 2018 - 1st half 2019
Overview of content

Transfer Pricing analysis (Actions 8 to 10)
— Accurate delineation of the transaction
— Economically relevant characteristics

Transaction Specific Guidance
— Loans
— Guarantees
— Cash Pools
— Other topics

Transfer Pricing analysis needs to be broader and more robust
Delineation of the financial transaction

Definition
Following BEPS Actions 8 to 10 and the updated OECD Guidelines:

— “Identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations…”

What does this mean?
— Not just concentrating on the intra-group transaction pricing
— A wider analysis including context and background

Is the loan really a loan?
Economically relevant characteristics
Options realistically available to both parties need to be considered
Inter-company loans - attribution of income

- Risk-free rate: Due to the provider of the capital
- Risk return: Due to the entity controlling the risk
- Arm's length rate: Paid by the borrower

No cash boxes
Inter-company loans - pricing methods

Pricing Methods

- Internal CUP
- External CUP
- Cost of Funds

Group average interest rate

Not endorsed

Bank opinions
Inter-company loans – pricing in detail

All relevant drivers should be priced into the interest rate.

How to evaluate the financial strength?

- Commercial credit rating tools can be useful, but additional analysis may be necessary
- Implicit support needs to be considered

How should certain loan terms be priced?

- Intra-group loans may not require certain restrictive covenants
- Collateral available, may need to be considered
Cash Pools

Role of Cash Pool Leader (CPL)
- Co-ordination vs Risk management

Is it being used as a Cash Pool?
- Short term vs Long term / equity

What are the risks?
- Are the risks taken comparable to loans?

Pricing

- CPL role?
- Short term?
- Risks?

How should the netting benefit be shared?

Defining a cash pool
- No clear guidance
- Notional vs physical
- Master file
Cash Pools - simplified example

What is the benefit?
- Sub-account 1 using Group cash

How to allocate the benefit?
- Use external rates? = Benefit Master Account
- Allocate the benefit to the depositors
- Same interest rate for all
- Allocate to all participants

Continually Monitor
- Are the benefits being shared correctly?
- Is it being used as a Cash Pool?
Guarantees - scope of OECD guidance

Explicit financial guarantee

Letter of comfort

Implicit support

Cross-guarantees

Performance guarantee

Might be priced, if there is a benefit

Not usually priced

Not covered
Guarantees - benefit and pricing

Explicit financial guarantee

Benefit
- No benefit
- Enhanced borrowing capacity
- Enhanced interest rate

Pricing
- No charge
- No charge
- Arm’s length charge (CUP, Cost or yield approach)

How does it fit in with the practice in Sweden?
Other topics - captive insurance

1. Is the insurance genuine?
   - Actuarial approaches

2. Pricing insurance
   - Combined ratio / return on capital
   - Allocation of synergies

3. Pricing agency
   - Remuneration of agency function

Arm’s Length Price
Other topics - hedging

- Treasury Inc.
- Market
- Risky co.
  - Hedge contract
- Service remuneration

- Treasury Inc.
- Market
- Risky co.
- Natural hedge
- Service remuneration

- Treasury Inc.
- Market
- Risky co.
- Hedge contract
- Service remuneration

- Treasury Inc.
- Market
- Risky ltd.
- Hedge contract
- Service remuneration

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5 key takeaways

1. OECD guidance has given Tax Authorities an additional tool

2. Transfer Pricing analysis needs to be broader and more robust

3. Cash pool and loan pricing should be continuously monitored

4. Some common pricing solutions for intra-group lending and cash pools will not work

5. Review and risk assess
Thank you!

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