Deloitte.

Dbriefs

Treasury Transfer Pricing – Focus on Debt Pricing and Cash Pooling

The Dbriefs Transfer Pricing series

Anushree Jagnani, Michael Sun, Philip Moralee, Priscilla Ratilal, Theppine Kyi, Trina Maitra, and Vrushang Sheth

17 October 2023

Agenda

- Treasury Transfer Pricing Complexities and Recent Trends
  - Australia
  - China
  - Hong Kong
  - India
  - Japan
  - Singapore
  - Malaysia
  - Other SEA countries

Treasury Transfer Pricing Complexities & Recent Trends

Loans and Cash Pooling Structure

Australia

Tax authority trends

- Recent transfer pricing cases decided in favour of the Australian Tax Office were financing cases, i.e., Chevron and Singtel
- The principle that multinational enterprises would always raise funds at the lowest possible cost
- Use of security and guarantees wherever possible
- Other factors: tenor, currency, fixed versus floating rates
- Need for commercial rationale when entering into and amending intercompany agreements
- Focus on treasury policies and funding practices of multinational groups

Polling question 1

What is your organization’s most significant challenge in managing financial transaction transfer pricing in the current regulatory and economic landscape?

- Compliance with evolving transfer pricing regulations.
- Mitigating foreign exchange rate risks
- Allocating capital efficiently across subsidiaries
- Managing increased documentation requirements
- Ensuring the accuracy and fairness of transaction pricing
- Adapting to emerging technologies for transfer pricing
- Don’t know/not applicable

China

Cross-border loan with China

Quota control and tax considerations

Quota control for x-border loan

“Investment-capital gap” method

“Macro-prudential” financing management system

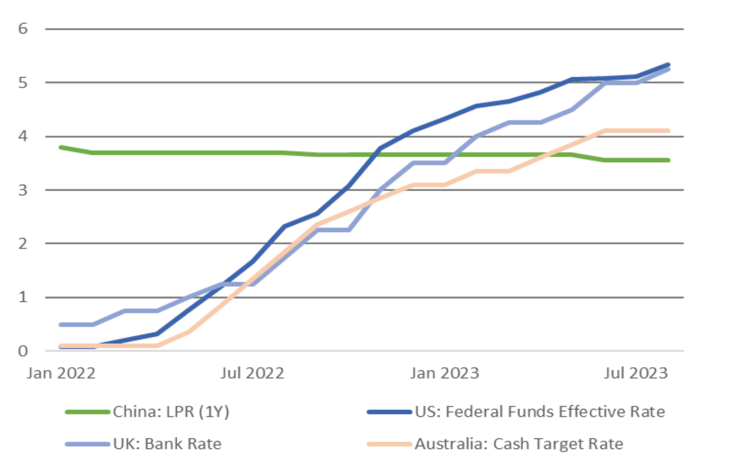
Tax considerations for cross-border loan

Value Added Tax | Stamp Duty | Withholding Tax

Transfer Pricing and Corporate Income Tax (CIT)

- **Debt-to-equity** ratio for thin cap management and interest deduction
- Thin cap **special matter TP report**
- **Arm’s length pricing** of financial transactions

Transfer pricing for cross-border loan



- **Widened interest rate difference** between CNY and major foreign currencies led by central bank policies
- **Local creditworthiness and benchmarking** analysis may be required
- Financial transactions under **greater interest** of China STA

Cross-border cash pool

An accessible structure to capture treasury opportunity

Benefits

- Optimization: Reduce funding cost and improve treasury management efficiency
- Mobility and cash concentration;
- Centralized for better visibility and control
- Scalable to support for future needs

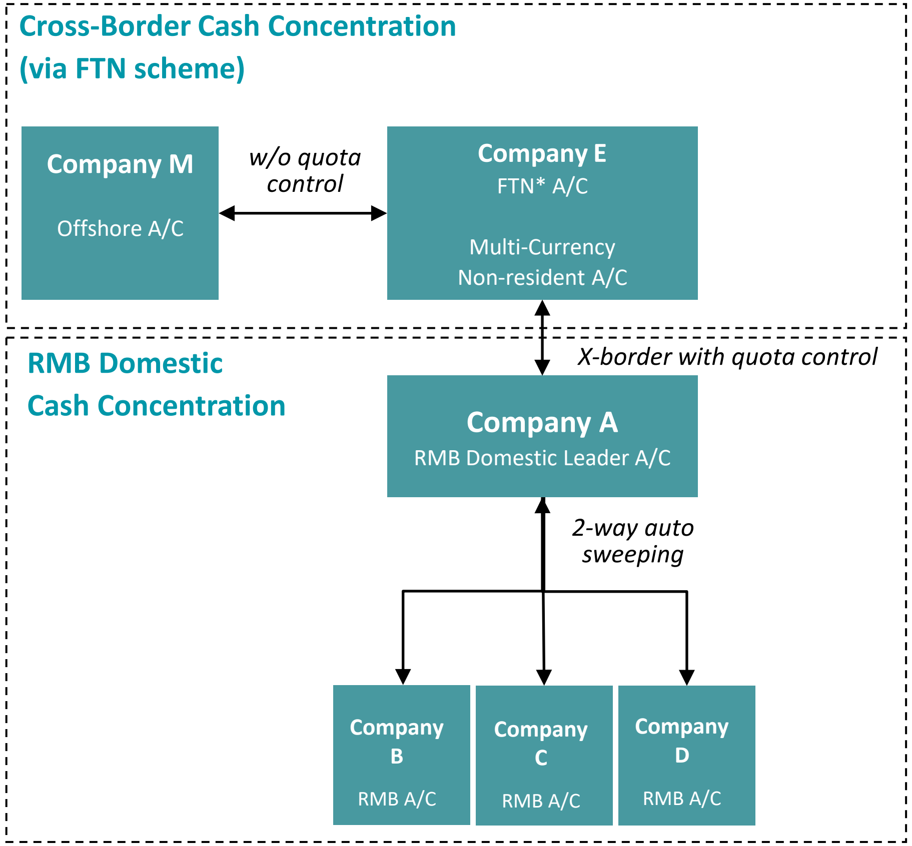
Regulatory Requirements

- PBOC registration where net asset and revenue of pool leader and participants may be reviewed
- X-border borrowing/lending quote control;
- Working capital purpose only
- Cross-border sweeping repaid within 1 year

Key transfer pricing considerations

- Commercial reason and benefits by the x-border cash pool;
- Creditworthiness analysis: start from China or global?
- Interest rate analysis: onshore only or holistically? Options realistically available to participants?
- Pool leader remuneration: spread of interest rate between deposit & borrowing, onshore & offshore (or not?)

Illustration of X-border Cash Pool Structure



** FTN stands for "Free Trade Non-resident"*

Hong Kong

Treasury functions

Common transfer pricing models

Profit centre approach

- Treated as a profit-generating unit of the MNE
- Characterised as an in-house financial institution, servicing affiliates in a similar way to how a bank would
- Transfer pricing implications
  - Clear visibility into the value created by th treasury function
  - To be remunerated in a way commensurat with functions performed, risks assumed versus assets employed
  - Profit allocation may be exposed to scrutiny from tax authorities
  - Benchmarking approaches to allocate profits to treasury function based on value created: CUP method/TNMM

Treasury functions

Cost centre approach

- Treated as a cost-bearing unit within the MNE group
- Characterised as a provider of routine services, coordinating and optimising internal liquidity across the MNE group (i.e., support service to the main value-creating operations)
- Focus is on cost efficiency and optimising resource allocation
- Transfer pricing implications
  - Straightforward method of allocating costs plus a margin within the MNE group - costs are allocated to entities that benefit from the services
  - Benchmarking approaches: Direct cost allocation/ Cost allocation using an appropriate allocation key

Applying the transfer pricing rules in Hong Kong

Hong Kong Territorial Basis of Taxation

* Only Hong Kong sourced income is subject to tax
* Limitations on interest deduction rules for non-financial services groups
* Foreign-sourced Income Exemption (FSIE) Regime effective as from 1 January 2023
*

Hong Kong Transfer Pricing Rules

* Arm's length principle
* Potential tax advantage in Hong Kong

Corporate Treasury Centres (CTCs) Tax Regime

* Effective from 1 April 2019
* Aim to encourage corporates to use Hong Kong as a CTC hub
*Incentive: Qualifying CTC to enjoy concessionary tax rate of 8.25% (instead of 16.5%)

Typical trends in the Hong Kong market

Transfer pricing issues

LIBOR cessation

Credit rating

Benchmarking approach

Data sources/ availability

Interest deduction rules

Intercompany balances

Interest free loans

Polling question 2

Is your treasury still evaluating financial transaction transfer pricing policy through legacy approaches? How frequently does your organisation conduct a review of its treasury transfer pricing policies and strategies?

- Annually
- Semi-annually
- Following a legacy transfer pricing approach
- Ad hoc pricing is being followed
- Don’t know/not applicable

India

Central Treasury Transfer Pricing – Intragroup loans and Cash pooling

Central Treasury hubs – Trends in Indian FSI

Treasury hub localisation – Practical considerations:

- Cost of funds, regulatory constraints, taxes, etc. - Less preferred in India
- Cross border intra-group **"cash pooling"** not allowed in India

- No specific guidance under Indian TPR – OECD TP guidelines on financial transactions (Chapter X) – lenders and borrowers' perspective

- Banks have policies on Inter-branch borrowing/lending for Asset Liability Management ('ALM') functions, regulated by the Central Bank

- Framework for Corporate Treasury Centre Activities – units of finance companies incorporated in IFSC GIFT city

Recent Central Bank Master direction dt. 12 September 2023 for commercial banks operating in India

- Classification, Valuation, and Operation of investment portfolio – Fair Value Through P&L (FVTPL) and Held For Trading (HFT)
- Hedge instruments (derivatives) – Accounting framework, reporting, documentation and valuation of underlying hedged instruments
- Accrual method of accounting v/s Guidance note on accounting for Derivatives Contracts – Tax implications

Financing Transactions – TP trends and controversies

- Recharacterizing ‘outbound’ capital contribution as loan and imputing interest income thereon
- Recharacterisation of ‘inbound’ debt contribution as equity and interest disallowed
- Regulations in India permit hybrid/convertible debt financing to attract FDI – CCDs, etc.
- Currency of loan for determining base rate of interest (i.e., LIBOR V/s. Local PLR/MCLR), loan date, tenure, geography of lender, security, subordination, etc. – Settled issue in many judicial rulings
- Safe harbour rules on provision of intra-group loans to AEs – INR & FCY denominated
- Interest on overdue/deferred receivables
- Issue of shares at value lower than or higher than FMV/ALP

Debt instruments transaction like CCDs/ NCDs/ECBs are subject to TP audit scrutiny

Japan

Japan FTTP Focus and Recent Trends

In 2022, Japan's National Tax Agency (NTA) finalized amendments to the Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines) regarding financial transactions

Delineation of Financial Transactions

- There is an increased risk of recharacterization of intercompany financial transactions due to examiners' potential lack of understanding of complex treasury arrangements and third-party debt instruments and markets

Renewed Focus on Application of CUP

- The use of yield bond indices and cost of funds, as opposed to other sources of interest rate data, is likely to be an area of debate in tax examinations, given their regular use in global FTTP policies and operations

Rolling Over Short-Term Loans/Cash Pooling

- Distinct short-term characterization
- Principally aligned with Chapter X

Singapore

Application of the Chapter X of OECD TP Guidelines – Singapore

- Singapore introduced additional guidance on related party financial transactions as part of the 6^{th} edition of the Singapore TP Guidelines released in August 2021
- The 6^{th} edition explicitly references and incorporates the guidance in Chapter X of the OECD TP Guidelines with respect to the pricing of financial transactions
- Application of the arm's length principle to price-related party loans largely aligned with Chapter X of the OECD TP Guidelines
- Singapore has in place rules which restrict the amount of interest expense and borrowing costs that can be claimed via its Corporate Tax rules
- The 6th edition of the Singapore TP Guidelines incorporates an additional step requiring the qualitative analysis of purported loans as per Chapter X of the OECD TP Guidelines
- The Singapore Guidance requires an accurate delineation of the transaction and suggests several useful indicators to consider as part of the analysis. These are consistent with those in the OECD TP Guidelines and the IRAS' e-tax Guide on Hybrid Instruments
- **Current trends**
  - Increase in enquiries by IRAS regarding guaranteed payments
  - Increase in enquiries by IRAS relating to related party financing transactions in the real estate sector

Malaysia

Tax regulatory updates having a direct impact on transfer pricing policies for intra-group financing

Malaysia

Key updates

Guarantee fee as a deductible expense

- Ketua Pengarah Hasil Dalam Negeri v Persatuan Nelayan Kebangsaan (Court of Appeal)
- Historically the Malaysian tax authority adopted a position that guarantee fee is a capital expense and accordingly, cannot be claimed as a revenue item
- In a domestic situation, it created double exposure for clients where guarantee fee income was taxable while expense was disallowed
- In the above case, it was successfully argued that guarantee fee was essential to functioning of taxpayer and procuring supply of key products and accordingly should be treated as deductible expense

Foreign sourced income now taxable

- Since June 2022, foreign sourced income (including interest income) is taxable provided it is remitted to Malaysia
- This has led to Malaysian HQ companies considering to charge interest to its subsidiaries based outside of Malaysia (earlier some corporations didn't charge to avoid unnecessary litigation)
- Interpretation of this change on imputed interest (and accordingly question of remittance does not arise) by the tax authority still needs to be evaluated specifically from the perspective of application of 5% surcharge applicable on value of transfer pricing adjustments

Earning Stripping Rules (ESR)

- The interest deduction is restricted to 20% of Tax-Earnings Before Interest, Tax, Depreciation, and Amortisation (Tax-EBITDA)
- Interest expense includes interest in all forms of debt or payments economically equivalent to interest
- The ESR Rules apply to a person whose total interest expense for all financial assistance granted in the controlled transaction exceeds RM 500,000 in the basis period for a YA
- A company will be subjected to ESR if it has the following transactions
  - Payment of interest to its associated person outside Malaysia
  - Payment of interest to its associated person outside Malaysia which operates through a permanent establishment in Malaysia; or
  - Payment of interest to a third party outside Malaysia where the financial assistance is guaranteed by its holding company or any other enterprises under the same MNE Group (regardless of the tax residence country of the guarantor)
- The interest expenses in excess of the maximum deduction allowed may be carried forward indefinitely to be deducted against future income (so long as there is no substantial change in the shareholders in the following year)

Other SEA Countries

Summary of current interest limitation rules in other SEA countries

SEA	Specifications
Indonesia	• Indonesia has thin-cap rules which provide for a maximum debt-to-equity ratio (DER) of 4:1. The regulation also states that if the taxpayer has negative equity, then the interest expense is not allowable • In addition, the Indonesian tax law in 2021 enacted a regulation which gives power to Ministry of Finance to adopt more methods other than DER to control the deductibility of borrowing costs, based on internationally accepted methods, such as borrowing costs compared to EBITDA, or other methods. However so far there has not been any new regulation on this aspect by MoF
Philippines	• There are no formal thin-capitalisation rules in the Philippines. But allowable interest deduction reduced by 20% of interest income that is subjected to final tax • However, TP Audit Guidelines specify that that the tax authority should consider the debt-equity ratio to test taxpayers' intragroup financing transactions
Thailand	• Thailand does not have any thin-capitalisation rules • However, certain capitalisation thresholds may apply if taxpayers are granted tax incentives by the Board of investment

Question and answers

Thanks for joining today's webcast.

You may watch the archive on PC or mobile devices via Apple Podcasts, RSS, YouTube.

Eligible viewers may now download CPE certificates. Click the CPE icon on your left hand side of your screen.

CPE

Contact information

Trina Maitra
Tax Director
Deloitte India
tmaitra@deloitte.com

Philip Robert Moralee
Tax Director
Deloitte China
pmoralee@deloitte.com.hk

Theppine Kyi
Tax Senior Manager
Deloitte Singapore
tkyi@deloitte.com

Anushree Jagnani
Executive Director
Deloitte India
ajagnanideo@deloitte.com

Priscilla Ratilal
Tax Partner
Deloitte Australia
pratilal@deloitte.com.au

Michael Yishun Sun
Tax Director
Deloitte China
michsun@deloitte.com.cn

Vrushang Sheth
Executive Director
Deloitte Malaysia
vsheth@deloitte.com

Join us 18 October at 2:00 PM SGT (GMT+8) as our Corporate Income Tax presents:

Tax collection at source in India: The conundrum continues!

For more information, visit www.Deloitte.com/ap/dbriefs