



OECD veröffentlicht Report zu Financial Transactions

Bisher boten die OECD Verrechnungspreisleitlinien nur wenig konkrete Hilfestellung bei der fremdüblichen Bepreisung von konzerninternen Finanztransaktionen. Im Zuge des BEPS Projektes beschäftigt sich die OECD jedoch auch intensiv mit dem Thema Finanztransaktionen und veröffentlichte nun nach langjähriger Arbeit ihre ersten Leitlinien speziell für Finanztransaktionen. Diese neuen Leitlinien der OECD beschäftigen sich mit den wichtigsten Arten von konzerninternen Finanztransaktionen. Sie umfassen unter anderem Krediten, Cash-Pools und Garantien.

The Organisation for Economic Co-operation and Development (OECD) on 11 February released final guidance on the transfer pricing aspects of financial transactions. The long-awaited release marks the first time the OECD transfer pricing guidelines (TPG) will be updated to include such guidance.

The report takes into account the comments received in response to the non-consensus public discussion draft released 3 July 2018 and was released as part of Actions 8-10 of the base erosion and profit shifting (BEPS) project, which began in 2013.

The 2015 final reports on BEPS Actions 4 and 8-10 mandated follow-up work on this topic. Pursuant to that mandate, the guidance is meant to clarify the application of the TPG to financial transactions, in particular, the accurate delineation analysis under Chapter I.

Sections A to E of the report will be included in the TPG as Chapter X. The guidance in Section F of the report will be added to Section D.1.2.1 in Chapter I of the TPG, immediately following paragraph 1.106. Section B provides guidance on the application of the principles contained in Section D.1 of Chapter I of the TPG to financial transactions. Sections C, D, and E of the report address specific issues related to the pricing of financial transactions (that is, treasury functions, intragroup loans, cash pooling, hedging, guarantees, and captive insurance). This analysis elaborates on both the accurate delineation and the pricing of the controlled financial transactions. The last section of the report provides guidance on how to determine a risk-free rate of return and a risk-adjusted rate of return in situations in which an associated enterprise is entitled to any of those returns under the guidance in Chapters I and VI of the TPG.

Overview

Debt versus equity determinations

The report includes guidance that reflects an approach of accurate delineation of the actual transaction to determine the capital structure (the mix and types of debt and equity) used to fund an entity within a multinational enterprise (MNE) group, although the report emphasizes that the guidance is not intended to prevent countries from implementing other approaches under domestic legislation.

The report indicates that an approach of accurate delineation, which may include a multifactor analysis, can be used before pricing a loan to determine whether the purported loan is regarded correctly or should be recharacterized as equity for tax purposes. Furthermore, the report suggests that the recharacterization as equity of a purported loan is not limited to an all-or-nothing consideration; rather, the report allows for a bifurcation of a purported loan between debt and equity as part of the accurate delineation analysis.

The report lists a number of factors that may be used to distinguish intercompany debt from other forms of funding such as equity, including the following:

- The presence or absence of a fixed repayment date;
- The obligation to pay interest;
- The right to enforce payment of principal and interest;
- The status of the funder in comparison to regular corporate creditors;
- The existence of financial covenants and security;
- The source of interest payments;
- The ability of the recipient of the funds to obtain loans from unrelated lending institutions;
- The extent to which the advance is used to acquire capital assets; and
- The purported debtor's failure to repay on the due date or to seek a postponement.

Identifying the commercial or financial relations and economically relevant characteristics of financial transactions

In accordance with the guidance established in Chapter I of the TPG, the report states that accurate delineation of financial transactions should begin with the thorough identification of economically relevant characteristics of the transaction, consistent with the application to other transactions. These include:

- An examination of the contractual terms of the transaction;
- The functions performed, assets used, and risks assumed;
- The characteristics of the financial products or services;
- The economic circumstances of the parties and the market; and
- The business strategies pursued by the parties.

The accurate delineation of a transaction “requires analysis of the economically relevant characteristics of the transaction. These economically relevant characteristics consist of the conditions of the transaction and the economically relevant circumstances in which the transaction takes place.” Depending on the context in which the term is used, the accurate delineation of a transaction may enable it to be correctly characterized (e.g., debt v. equity v. some apportionment between the two) and may entail the examination of factors that may impact comparability beyond a transaction or arrangement in isolation.

In applying the arm's length principle to a financial transaction, the guidance states that consideration of the conditions that independent parties would have agreed to in comparable circumstances is necessary. It is also necessary to consider the options realistically available to each of the parties to the transaction.

The report states that when the accurate delineation analysis shows that a funder lacks the capability, or does not perform the decision-making functions, to control the risk associated with investing in a financial asset, it will be entitled to no more than a risk-free return as an appropriate measure of the profits it is entitled to retain.

The report also states that an accurate delineation analysis should consider the MNE group's global financing policy, including preexisting loans and shareholder interests. In one example, a 10-year term loan is more accurately delineated (and therefore should be priced) as a series of refreshed one-year revolver loans, based on the MNE group's financial policy practices, and the use of the proceeds to manage short-term working capital requirements.

Treasury functions: Intragroup loans, cash pooling, and hedging

The report states that the organization of the treasury function will depend on the structure of the MNE group and the complexity of its operations. Differences in the treasury function may flow from variations in the function's degree of autonomy and the range of activities it performs. The report sets out transfer pricing considerations that arise from treasury activities such as intragroup loans, cash pooling, and hedging activities. The report also emphasizes that the treasury function will usually be a support service to the main value-creating operations of an MNE and in some cases, remuneration to the treasury function should be priced by applying the intragroup services guidance in Chapter VII of the TPG.

Intragroup loans

In determining an arm's length interest rate on intragroup loans, a number of factors should be considered, including:

- The lender's and borrower's perspectives;
- The borrower's credit rating and credit rating of a specific debt issuance;
- The effects of group membership (and associated implicit support);
- Incurrence and maintenance covenants;
- Guarantees; and
- Loan fees and charges associated with the transaction.

In considering the lender's perspective, the report suggests an evaluation of the lender's ability to bear the risks associated with the borrower's potential default on the loan. A similar concept is also seen in the section of the report on guarantees and the guarantor's ability to bear the financial risk associated with providing a contractual guarantee. Such an analysis is likely to be an important aspect of the accurate delineation of the transaction. However, the report does not offer any guidance or examples as to how the financial ability to bear the risk should be measured or evaluated.

In considering the borrower's perspective, the report states that a borrower acting on its own commercial interest would seek to optimize its weighted average cost of capital in balance with its short-term and long-term funding needs. In one example, the report suggests that a borrower would generally seek secured funding ahead of unsecured funding, provided it takes into account the potential need for subsequent financing transactions and the scarcity of collateral.

The report looks beyond contractual terms to consider that the lender and borrower are related parties, that the funding is in fact intercompany and not third-party debt, and that the borrower is a member of a larger MNE group. For example, consideration is given to the fact that intercompany loans are frequently subordinated to third-party loans in many jurisdictions. This suggests that there may be a need to perform a legal analysis with respect to bankruptcy laws and seniority. The guidance also highlights that covenants may be less important in a related-party context and that certain intragroup loans may effectively be secured lending even if no security is contractually given. Finally, consistent with paragraphs 1.164 through 1.167 of the TPG, the report considers the effects of group membership via implicit support, even in the absence of a contractual guarantee.

The guidance emphasizes the importance of both quantitative and qualitative factors in determining arm's length pricing. Qualitative factors include both the effects of group membership, as discussed below, and also qualitative aspects of the borrower's business. Specific guidance is provided on considerations for conducting credit rating analyses and performing comparability adjustments to account for influences of controlled transactions and the potential impact of passive association. The report acknowledges that credit ratings can serve as a useful measure of creditworthiness and to help identify potential comparables. Furthermore, the report highlights that in performing a credit rating analysis, it is important to note that the financial metrics of the borrower may be influenced by other controlled transactions (such as sales, or interest expense). In situations where a credit rating estimate for a particular entity using an established approach may result in an unreliable outcome (for example, due to the presence of controlled transactions), the report suggests that it may be appropriate to rely upon the group credit rating for pricing of an intragroup loan. However, no specific guidance or examples are provided as to how these situations should be best addressed.

The report considers implicit support to be an important factor in evaluating credit risk. The report proposes a facts and circumstances-driven approach based on the entity's relative importance to the group to determine the impact of implicit support. The report suggests that in cases in which the borrower would be likely to receive support from other group members, the borrower's credit rating is likely to be more closely linked to the group rating. In more limited circumstances, when a borrower is determined to be less likely to receive group support, the borrower's credit rating may be more closely linked to the stand-alone credit rating of the entity.

The report outlines the transfer pricing approaches to determine arm's length rates, including the comparable uncontrolled price (CUP) method, a cost of funds approach, credit default swaps, economic modelling, and reliance on bank opinions. However, the report indicates that the use of credit default swaps and economic modelling to price intragroup loans should be used only in the absence of information on comparable uncontrolled transactions. Further, the last item – reliance on bank opinions – generally would not be regarded as providing evidence of arm's length pricing.

Cash pooling

Cash pooling enables a group to benefit from more efficient cash management by (notionally or physically) bringing together the balances on separate bank accounts. The report indicates that accurate delineation of cash pooling arrangements would need to take into account the facts and circumstances of the balances transferred, but also the broader context of the conditions of the pooling arrangement as a whole.

The report discusses two broad pricing schemes for cash pooling transactions: rewarding the cash pool leader and rewarding the cash pool members. The appropriate basis on which to reward the cash pool leader depends on the specific facts and circumstances of the arrangement.

The report discusses two approaches to allocating the benefits of cash pooling to the participating members (that are not necessarily mutually exclusive):

- Enhancing the interest rate for depositors and borrowers; and
- Allocating cash pooling benefits to depositors, and not borrowers, within the group (in situations in which there is genuine credit risk to the depositors).

The guidance states that cross-guarantees and set-off rights between participants in the cash pool may be required, which would raise the question whether guarantee fees should be payable. The guidance says that under circumstances where members providing cross-guarantees do not have control over membership in the pool, have no control over the quantum of debt that is guaranteed, and may not be able to access information on the parties for whom it is providing a guarantee, the guaranteed borrower may not be benefitting beyond the level of credit enhancement attributable to the implicit support of other group members. In such cases, the report concludes, no guarantee fee would be due, and support in case of a default from another group member should be regarded as a capital contribution.

In a discussion on hedging, the report states that when a centralized treasury function arranges a hedging contract that an operating company enters into, the centralized function can be seen as providing a service to the operating company and should be rewarded accordingly. However, when hedging positions are not matched within the same entity, even though the group position is protected, more difficult transfer pricing issues may arise.

Guarantees

The report provides guidance on how to accurately delineate and price financial guarantees.

As stated in the guidance, when the effect of a guarantee is to permit a borrower to borrow a greater amount of debt than it could in the absence of the guarantee, it is necessary to consider whether a portion (incremental borrowing capacity) of the loan from the lender to the borrower should be more accurately delineated as a loan from the lender to the guarantor (followed by an equity contribution from the guarantor to the borrower), and whether the guarantee fee paid with respect to the loan portion is arm's length.

The report discusses both explicit guarantees (legally binding contracts) and implicit guarantees (anything less than a legally binding commitment). In general, the benefit of any such implicit support would arise from passive association and not from the provision of a service for which a fee would be payable. In an explicit guarantee, a borrower generally would not be prepared to pay for a guarantee if it did not expect to obtain an appropriate benefit in return (that is, a cost of debt-funding lower than its non-guaranteed borrowing costs adjusted for implicit support and costs associated with the guarantee).

The report states that the examination of financial guarantees under accurate delineation also needs to consider the financial capacity of the guarantor to fulfill its obligations in case the borrower defaults. This requires an evaluation of the guarantor's and the borrower's credit rating (including the effect of implicit support), and of the business correlations between them.

The report describes five pricing approaches for circumstances in which a guarantee fee is found to be appropriate:

- The comparable uncontrolled price (CUP) method (although finding sufficiently similar guarantees between unrelated parties may be unlikely);
- The yield (differential) approach;
- The cost approach;
- The valuation of expected loss approach; and
- The capital support method.

The yield approach prices the guarantee based on the benefit provided to the borrower (that is, from the borrower's perspective), whereas the cost, valuation of expected loss, and capital support methods price the guarantee based on the cost to the guarantor (that is, from the guarantor's perspective). With the exception of the CUP method, these pricing approaches address only the maximum or minimum amounts an unrelated borrower or lender may be willing to pay or receive for a financial guarantee, and do not address how to consider prices above or below these limits.

Captive insurance companies

Some MNE groups manage risks within the group through a captive insurance company, a group member that provides insurance-type services exclusively or primarily to members of the group. The report provides guidance on applying the arm's length principle to these transactions. A frequent concern when considering the transfer pricing of captive insurance transactions is whether the transaction is accurately delineated as such. The report provides indicators, all or substantially all of which would typically be expected in an independent insurer:

- Diversification and pooling of risk in the captive insurance;
- The economic capital position of the entities within the MNE group has improved as a result of diversification and there is therefore a real economic impact for the MNE group as a whole;
- Both the insurer and any reinsurer are regulated entities with broadly similar regulatory regimes and regulators that require evidence of risk assumption and appropriate capital levels;
- The insured risk would otherwise be insurable outside the MNE group;
- The captive has the requisite skills, including investment skills, and experience at its disposal, including employees with senior underwriting expertise; and
- The captive has a real possibility of suffering losses.

The report emphasizes the importance of the captive's ability to control, and the financial capacity to assume the insurance risk when allocating risk (and return) to MNE group members.

In cases where the captive is not found to exercise control functions related to the insurance risk, an analysis under Chapter 1 of the TPG may conclude that the risk has not been assumed by the captive or that another MNE is exercising these control functions. In the latter case, the report states, the return derived from the investment of the premiums would be allocated to the member(s) of the MNE group that are assuming the risk.

Two methods are discussed that may be appropriate for the pricing of premiums: CUPs from available comparable arrangements between unrelated parties (or internal comparables) and actuarial analysis. The report also provides for a method that builds to an arm's length level of profitability as the sum of underwriting profit plus investment income. Further, the report provides guidance on the pricing of agency sales and arrangements whereby a captive is used to achieve synergies for the MNE group.

Risk-free and risk-adjusted rates of return

The report provides guidance on how to determine a risk-free rate of return and a risk-adjusted rate of return that is added to Section D.1.21 in Chapter I of the TPG.

If the accurate delineation of the actual transaction shows that a funder lacks the capability, or does not perform the decision-making functions, to control the risk associated with investing in a financial asset, the guidance states that it will be entitled to no more than a risk-free rate of return.

The guidance mentions that government-issued securities serve as one -- but not the only -- reference for estimating risk-free rates, and other alternatives may be considered based on the prevailing facts and circumstances of each case. Alternatives may include interbank rates, interest rate swaps, or repurchase agreements of highly rated government-issued securities.

The report refers to the following relevant considerations for determining a risk-free rate:

- Eliminating currency risk;
- Temporal proximity of the reference security to the tested transaction; and
- Matching the maturity of the reference security to the tested transaction.

The report states that in a situation in which a party providing funding exercises control over the financial risk associated with the provision of funding, without the assumption of or control over any other specific risk, it could generally expect only a risk-adjusted rate of return on its funding. In general, the expected risk-adjusted rate of return on a funding transaction can be considered to have two components, i.e., the risk-free rate and a premium reflecting the risks assumed by the funder.

The report discusses several approaches for estimating a risk-adjusted return, including those that are based on the return of a realistic alternative investment with comparable economic characteristics, a cost of funds approach, or a risk-premium to the risk-free return based on the information available in the market on financial instruments issued under similar conditions and circumstances.

Conclusion and key takeaways

The guidance provides methods for determining the arm's length compensation for financial transactions, and it emphasizes an accurate delineation analysis as an approach to determine whether the transaction is characterized correctly or should be recharacterized for tax purposes. To accurately delineate financial transactions, the report indicates that it is necessary to perform an examination of the transaction's contractual terms (explicit and delineated); the functions performed, assets used, and risks assumed; the economic circumstances of the parties and the market; and the business strategies pursued by the parties.

Overall, the guidance provided in the report highlights the need for MNEs to revisit and develop intragroup policies (and revisit associated funding agreements) to address any ambiguity regarding how tax authorities might interpret their intragroup financing transactions.

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