Une crise économique en trois dimensions

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Depuis quelques semaines, le contexte économique, qui n'était déjà pas très brillant, s'assombrit rapidement. Bien sur, la première raison en est l'expansion de l'épidémie de coronavirus. Mais cela demande quelques explications, car le choc dépasse de plus en plus l'effet direct de l'épidémie. Essayons donc ici de structurer la triple menace qui pèse sur l'économie mondiale, et qui a déjà poussé la plupart des banques centrales à prendre des mesures d'envergure.

Impact direct

Primo, la menace économique liée à l'épidémie elle-même reste la principale préoccupation. En effet, en réaction à la propagation du virus et pour endiguer celle-ci, la Chine a imposé des mesures drastiques de confinement. Les pays les plus touchés par l'épidémie en font de même, ce qui va multiplier les problèmes d'approvisionnement des entreprises. C'est un problème économique sérieux qui peut toucher un nombre croissant d'entreprises, même en dehors des zones confinées. Parallèlement, les personnes dans les zones confinées diminuent leurs dépenses de consommation (services divers, loisirs, Horeca, tourisme). Le reste de la population a probablement aussi un réflexe de limiter ses activités. Au choc d'offre lié à l'approvisionnement vient s'ajouter un choc de demande sur la consommation.

L'incapacité de produire ou de vendre et le réflexe d'une moindre consommation ont, à court terme, des conséquences sur la valeur ajoutée créée par les entreprises (donc sur le PIB), mais peut aussi créer des soucis financiers (manque de liquidités). On voit d'ailleurs que les banques centrales centrent leurs mesures sur ce dernier problème.

Retour de flammes

Secundo, la menace financière vient également des marchés. L'incertitude créée par l'épidémie et ses conséquences économiques a dans un premier temps provoqué une correction sur les marchés boursiers. C'est normal, puisque les attentes bénéficiaires sont au mieux devenues incertaines, mais doivent dans un nombre croissant de cas déjà être révisées. Ceci fait craindre qu'en retour, les corrections sur les marchés financiers aient un impact sur l'économie : on sait par exemple que la consommation des ménages aux États-Unis réagit à une correction des marchés financiers. Mais il faut aussi penser à l'augmentation des primes de risque, ou encore à l'impossibilité de se financer sur certains marchés compte tenu de l'absence d'investisseurs.

La menace est d'autant plus grande que les corrections se multiplient et deviennent de plus en plus fortes. Ceci laisse penser que les marchés financiers sont entrés dans une phase de panique où les nouvelles économiques et de l'épidémie n'ont plus beaucoup d'importance : le marché réagit davantage à des peurs et ses réactions sont brutales.

Géopolitique

Tertio, la menace du pétrole vient troubler encore plus le scénario économique. La correction très brutale du prix du pétrole est l'illustration d'un mouvement de panique, en réaction à la peur d'une guerre des prix lancée par l'Arabie saoudite.

Suite au ralentissement de l'économie, on aurait en effet pu attendre que les pays de l'OPEP décident de réduire leur production pour stabiliser le prix du pétrole. Mais ces pays n'ont pas pu s'entendre. Au contraire, l'Arabie saoudite a décidé de vendre plus de pétrole et moins cher. La chute du prix du pétrole pourrait *a priori* être une bonne nouvelle pour le pouvoir d'achat des consommateurs. Mais il faut tenir compte d'autres facteurs : d'une part, cette situation est le reflet de tensions géopolitiques entre les pays producteurs, ce qui pourrait encore détériorer le contexte économique mondial. D'autre part, la chute vertigineuse du prix du pétrole peut avoir des conséquences financières graves sur des entreprises actives dans ce secteur ou des opérateurs financiers. Ceci pourrait en retour encore attiser le problème financier décrit ci-dessus.

On l'aura compris, les trois menaces sont interconnectées. Certains diront que c'est une tempête parfaite. En dehors des métaphores alarmistes, il faut rationnellement considérer que ces menaces vont affecter sensiblement l'activité économique de cette année. L'ampleur de l'impact dépendra de l'épidémie elle-même et de sa durée, ainsi que des mesures qui seront prises pour limiter les dégâts collatéraux. Pour l'ensemble de l'économie mondiale, un choc au cours de la première moitié de l'année doit néanmoins déjà être acté. L'hypothèse d'une récession mondiale sur l'ensemble de l'année n'est pas encore d'actualité. Mais un emballement de l'épidémie (et les mesures que cela suppose) et/ou un choc financier nous y emmèneraient directement.

Cette crise va donc à la fois tester la capacité de résilience de nos systèmes de santé ET de nos économies. Gardons néanmoins à l'esprit que la priorité reste la santé publique. Les performances économiques passent au second plan.

The OECD's Transfer Pricing Guidance on Financial Transactions:

Three key implications for Luxembourg

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On 11 February 2020, the OECD released the report *Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS: Actions 4, 8-10* (the Report). The Report will be included as Chapter X of the internationally regarded OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines). The Report is the first dedicated guidance issued by the OECD in the area of intragroup financial transactions. This article discusses three key transfer pricing (TP) implications for Luxembourg.

As a financial center of global significance, Luxembourg is home to numerous investment and corporate structures involving intra-group financial transactions. The Report is the first ever TP guidance issued by the OECD on this subject and therefore marks an important development for TP practices in Luxembourg.

The Report covers many types of financial transactions, but we will focus on three, key, impact areas for Luxembourg, considering the nature of the intra-group financial transactions entered into by local taxpayers.

Debt to equity ratio

Multinational enterprises (MNEs) have traditionally focused their attention on supporting the arm's length compensation of their intra-group financial transactions. The Report calls for a shift of this focus as it sets forth the need to assess the rationale of the financial transaction as a whole. In other words, whether the transaction would have occurred in a third party context and under which conditions, before determining the compensation that would have been agreed upon under similar circumstances.

The Report proposes an accurate delineation of the controlled transaction to carry out this assessment. This approach considers all economically relevant characteristics of the controlled transaction and the economic factors that surround it in order to conclude its arm's length nature.

Accurate delineation analysis is one of the key aspects established in the OECD TP Guidelines for the application of the arm's length principle. In Luxembourg, these aspects were embedded into local legislation via Article 56bis of the Luxembourg Income Tax Law, applicable to all controlled transactions. The Report provides further concepts and guidelines on the application of the accurate delineation analysis, specifically framed in the context of controlled financial transactions.

Addressing the rationale for the overall transaction, the accurate delineation approach sets the need to evaluate whether the debt-to-equity ratio that would be reached by the MNE group entity, when entering into the transaction, would be consistent with the arm's length principle.

In this context, there are currently several approaches applied worldwide by TP practitioners for the economic analysis of an arm's length balance of debt and equity funding. These approaches refer to: i) peer analysis: assessing third party loan agreement covenants or leverage ratios of comparable independent entities ii) cash flow forecast analysis: modelling future financial liquidity and capacity to repay a loan over a given timeframe, and iii) expected loss analysis: observing default rates across a large number of debt issuers. Among these approaches, the cash flow forecast analysis is mentioned by the Report in the context of activities generally carried out by independent lenders when deciding whether or not to advance a loan. However, the Report is not conclusive as to the preferred approach for performing such a debt-to-equity analysis and recognizes that other economic analyses may be useful.

In Luxembourg, given the absence of domestic legislation, different approaches were followed by taxpayers and tax authorities in practice, for the assessment of debt-to-equity ratios. These approaches were mostly driven by convenience and the willingness to ensure certainty for taxpayers.

Local practices will likely evolve and align with the guidance of the Report as an authoritative reference framework for the TP assessment of debt-to-equity ratios, with a further reliance on developed approaches for the economic analysis of their arm's length nature.

On-lending financing structures

Luxembourg issued at the end of 2016 a specific Administrative Circular(1) (Circular) applying to Luxembourg taxpayers functioning as intra-group financing companies. However, the Circular did not include specific guidance in relation to the TP methodology to be applied when assessing the arm's length nature of the TP positions of such companies.

The Report proposes a 'cost of funds' approach to determine the compensation for intra-group financing companies. Under this approach, interest rates charged by lenders on intra-group loans are built upon the lender's borrowing costs, with additional elements such as a risk premium incorporated into the loan's interest rate.

In regards to the risk premium, traditional Luxembourg on-lending structures generally involve financing agreements that bear similar features. However, when these agreements bear different features, the 'cost of funds' approach would account for this element via a risk premium to be added into the profit margin of the lender, to account for the additional risk brought about by the dissimilar features. Alternatively, these dissimilar features in Luxembourg on-lending structures have been addressed by applying the 'comparable uncontrolled price' method, considering the specific features of the loans received and granted and pricing the interest rate of each. Both approaches should not be considered mutually exclusive and the results achieved through each should, in principle, be corroborative.

Given the defining characteristic of the 'cost of funds' approach, i.e., building upon the lender's borrowing costs, current Luxembourg TP practices, based on the Circular, addressing on-lending financing structures, could be explained under the framework of the 'cost of funds' approach. For example, the approach specifically refers to a profit margin for the on-lending entity, integrated into the interest rates, computed based on the cost of equity required to support the loan.

Further to traditional Luxembourg on-lending structures, the Report also references intermediary functions, characterizing them as the activities carried out by a company that advances funds without assuming the risks connected to the funding, with an emphasis being made on the need to compute profit margins based only on the value input of each intermediary.

While the Report serves to affirm TP practices currently followed to assess traditional Luxembourg on-lending structures, certain elements of the 'cost of funds' approach, such as the embedded risk premium, are expected to bring about further evolution in these practices. Specifically, the risk premium may be used to address differences present in the terms and conditions of the financing agreements within on-lending structures.

Cash pool

Luxembourg legislation does not specifically address TP aspects of cash pooling arrangements, as these types of arrangements are considered, in principle, to be outside the scope of the Circular.

Different approaches were developed and applied in the local market in order to assess the arm's length nature of cash pool arrangements. These approaches differed mainly in the treatment of the allocation of benefits arising from the arrangement, i.e., integrated into the cash pool rates or treated through a separate transaction. However, when addressing the allocation of the cash pool benefits, the Report only envisages enhanced interest rates as the means for the benefits of the cash pool to be assigned between its members.

For allocating the cash pool benefits among participants, while no prescriptive approach is included in the Report, several considerations tend towards allocating the benefits of the arrangement between all participants, i.e., depositors and borrowers.

As regards the cash pool leader, the Report sets forth the generally observed functionality of leaders as entities performing no more than a co-ordination or agency function. In order for cash pool leaders to go beyond this general characterization, the Report sets a relatively high functionality threshold by referencing a series of activities expected to be assumed by the cash pool leader, which would be usually linked to broader treasury role functions. In addition to liquidity risk and credit risk, risks linked to the specific characteristics of the cash pool arrangement, such as currency risk, should also be considered when assessing the functionality of the cash pool leader.

For Luxembourg entities engaging in cash pooling arrangements, the guidance provided in the Report highlights the need to assess the cash pool arrangement in itself, the functional profile of the cash pool leader, and the characteristics of their position in the cash pool. Local practices and requirements can be expected to further evolve, especially regarding the mechanics for allocating the cash pool benefits and the assessment of the cash pool leader's remuneration vis-à-vis its functional and risk profile.

Conclusion

The issuance of the Report marks an important development for Luxembourg as it constitutes a reference framework for transfer pricing assessment.

Key areas of impact relate to balance of debt and equity funding, on-lending structures, and cash pool arrangements. TP practices will continue to evolve in order to incorporate the guidelines and concepts included in the Report into different areas of the TP analysis of financial transactions.

Comprehensively, the Report calls attention to the need for Luxembourg companies to revisit their financing arrangements, policies, and TP documentation to address any uncertainty in how tax authorities may interpret (or reinterpret) their intra-group financial transactions.

1) Circulaire du directeur des contributions L.I.R. n56/1 -56bis/1 du 27 décembre 2016.