

How to Price Intra-Group Financial Transactions

SPEAKERS

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LIVE

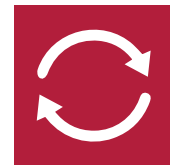
26 March 2024

15:00 - 16:00 CET

Facilitated by: Birhanu Tadesse Daba, *IBFD, the Netherlands*



Agenda



Overview: OECD Guidelines on Financial Transactions

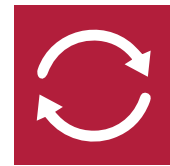


Accurate Delineation of Intra-group Transactions



Some Practical Tips Going Forward

Agenda



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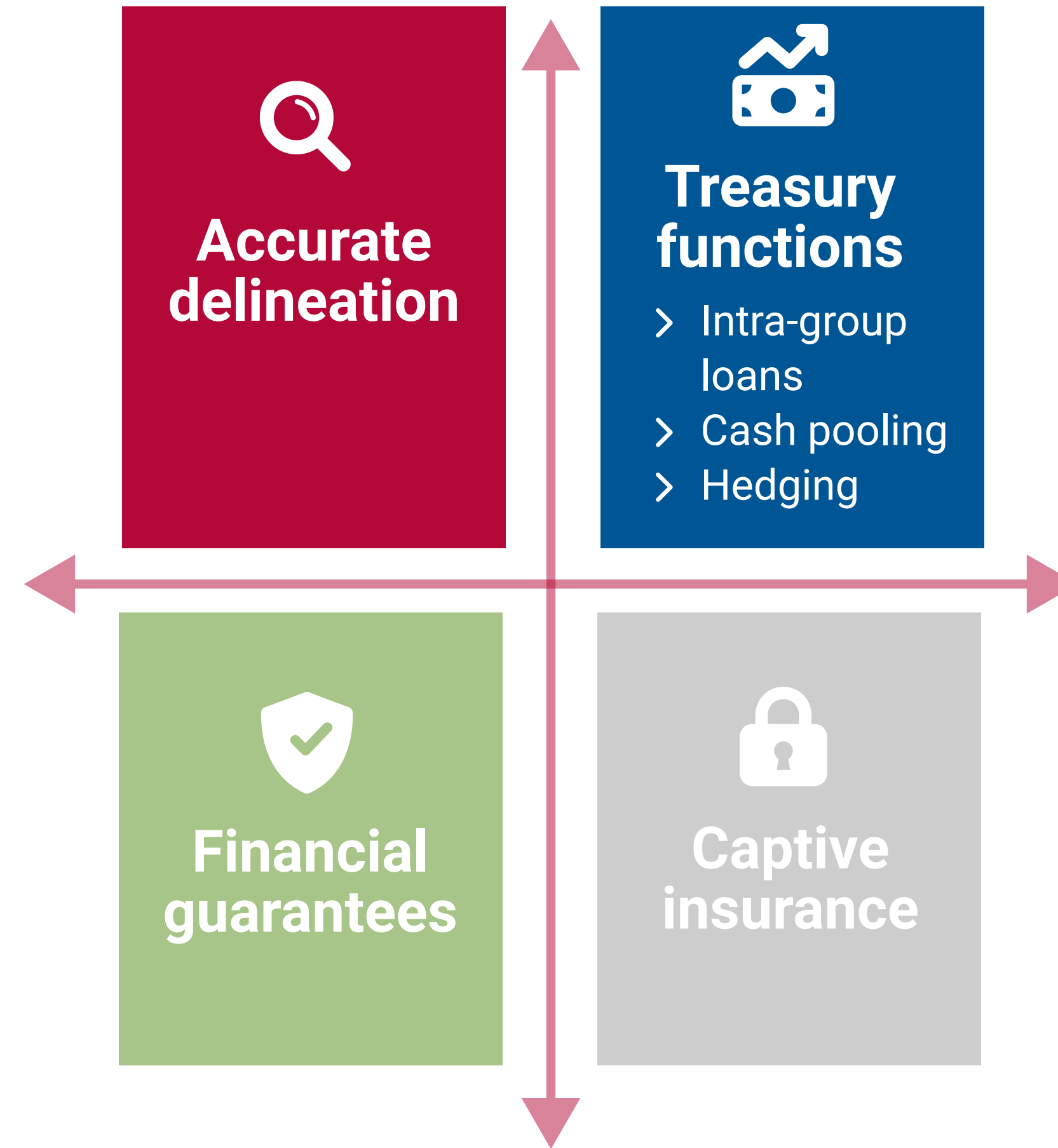


Accurate Delineation of Intra-group Transactions

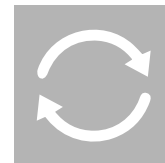


Some Practical Tips Going Forward

Practical Impact of the 2020 OECD Guidelines



Agenda



Overview: OECD Guidelines on Financial Transactions

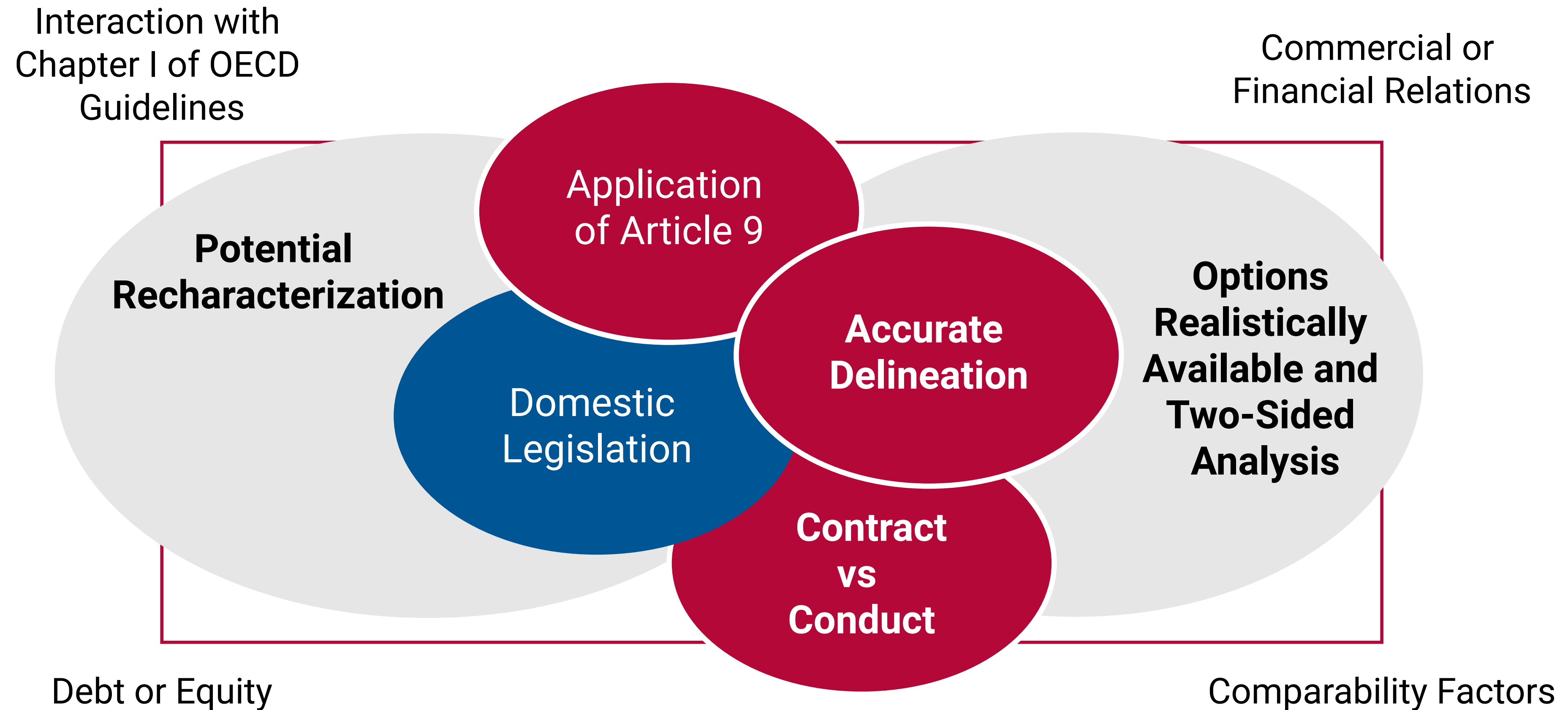


Accurate Delineation: When Does a Funding Transaction Occur?



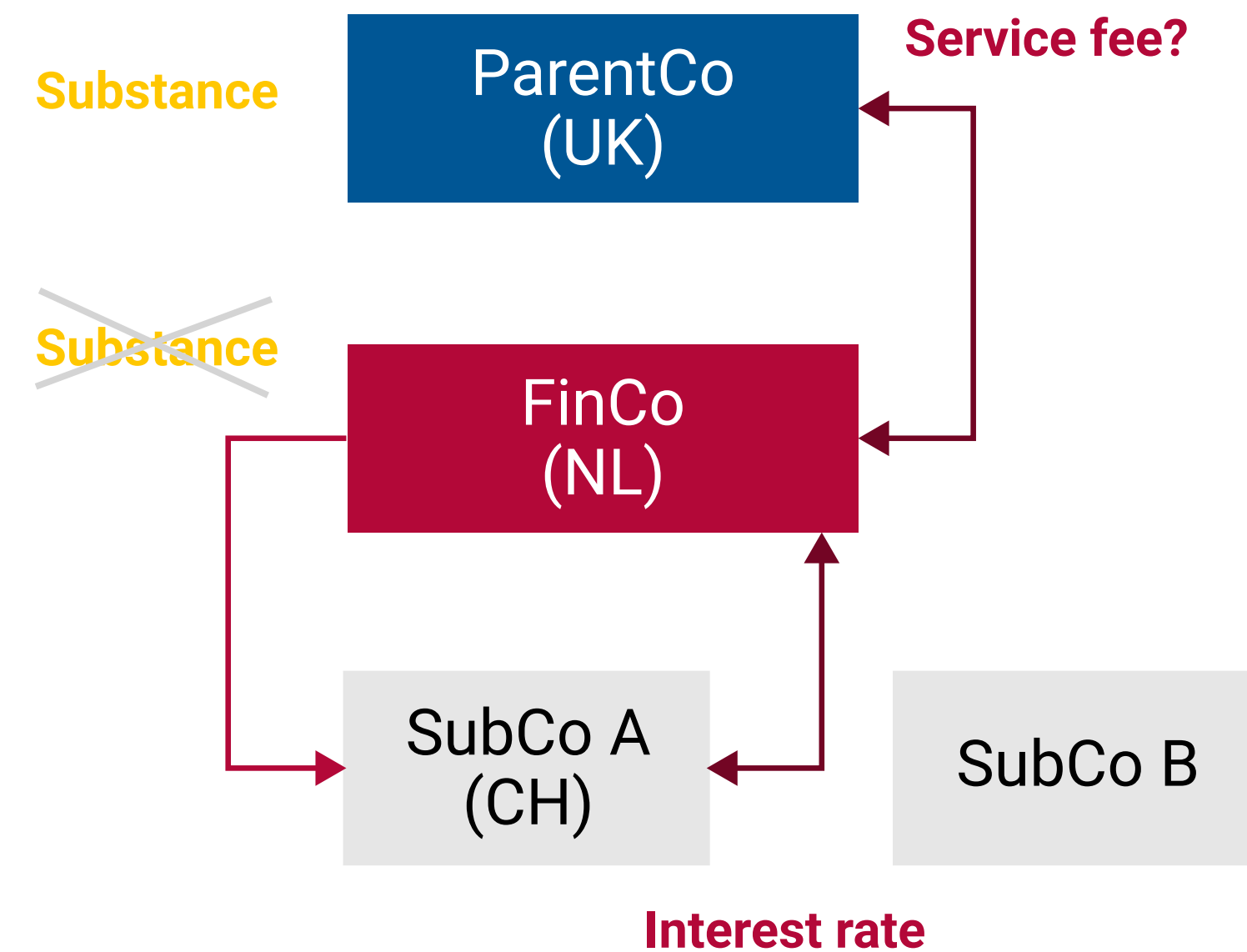
Pricing of Intra-Group Financial Transactions: Some Practical Tips

Accurate Delineation: Debt or Equity



Substance / Control over Risk

- Funder lacks capability to control the risk – RFR
- The funded party still can deduct an arm's length interest rate
- The difference between the RFR and arm's length rate is allocable to the party exercising control over the investment risk based on the accurate delineation



Poll Question 1

Question

How often do you consider the question of whether an intra-group transaction is a loan, or whether a loan could be considered an equity transaction?

A Always

B Often

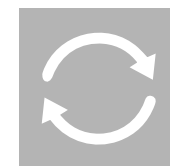
C Rarely

D Never

Recent Case Law

- **Luxembourg vs “LLC AB”, November 2023, Administrative Court of Appeal, Case No. 48125C**
 - *the Court must reiterate the finding already made above that the appellant made only very limited use of the credit line opened to it and that the loan was indeed repaid on December 31, 2018. However, neither the state party nor the first judges questioned this repayment. Therefore, in accordance with the principle of substance over form, and with the hindsight inherent in the analysis carried out at the litigation level after the end of the relevant transactions, the IFL was indeed executed by the parties as a loan that was repaid even well before the contractually agreed maturity date... .*
- **Malaysia vs Watsons Personal Care Stores Holding Limited, April 2023, High Court, Case No. WA-14-20-06/2020**
 - *Having read Rule 8 (1) and 8(2) of the TP Rules together, it is clear that while the DGIR has the power to disregard structures that differ from those which would have been adopted by independent persons behaving in a commercially rational manner and the actual structure impedes the DGIR from determining an appropriate transfer price, if DGIR so chooses to disregard the structure under Rule 8(1), Rule 8(2) requires the DGIR to make the adjustment as it thinks fit to reflect the structure that would have been adopted by an independent person dealing at arm’s length”... .*

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Overview: OECD Guidelines on Financial Transactions



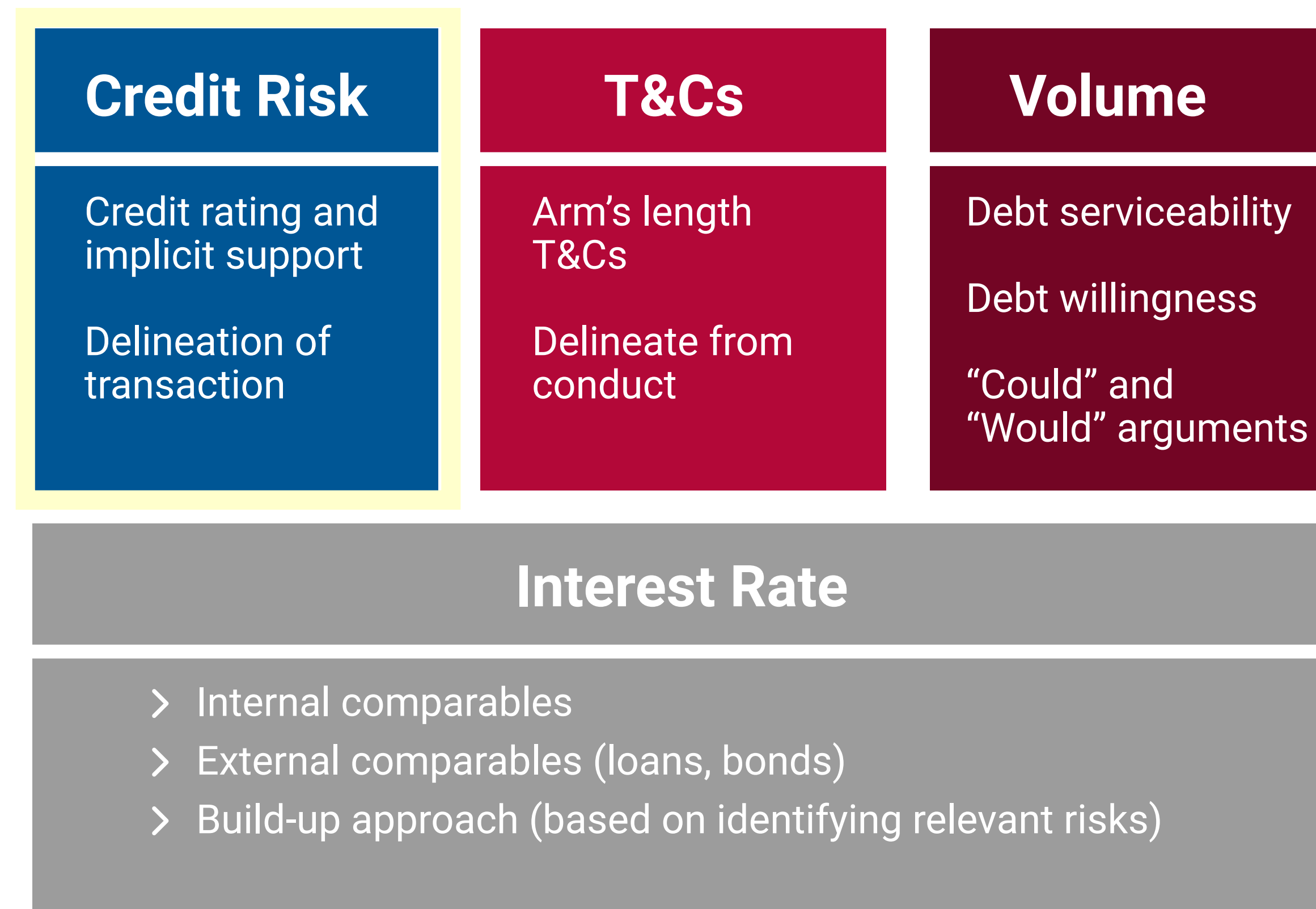
Accurate Delineation: When Will There Be a Funding Transaction?



Pricing of Intra-group Financial Transactions: Some Practical Tips

Pricing Intra-Group Loans

Arm's Length Loan Building Blocks



Determine the Credit Rating

Rating Process

Step 1: Is the MNE or group rated?

- If the MNE has an official rating, this might be informative for arm's length analysis

Step 2: Determine importance of the borrower

- Determine strategic importance of the borrower within the group using guidance from credit rating agencies

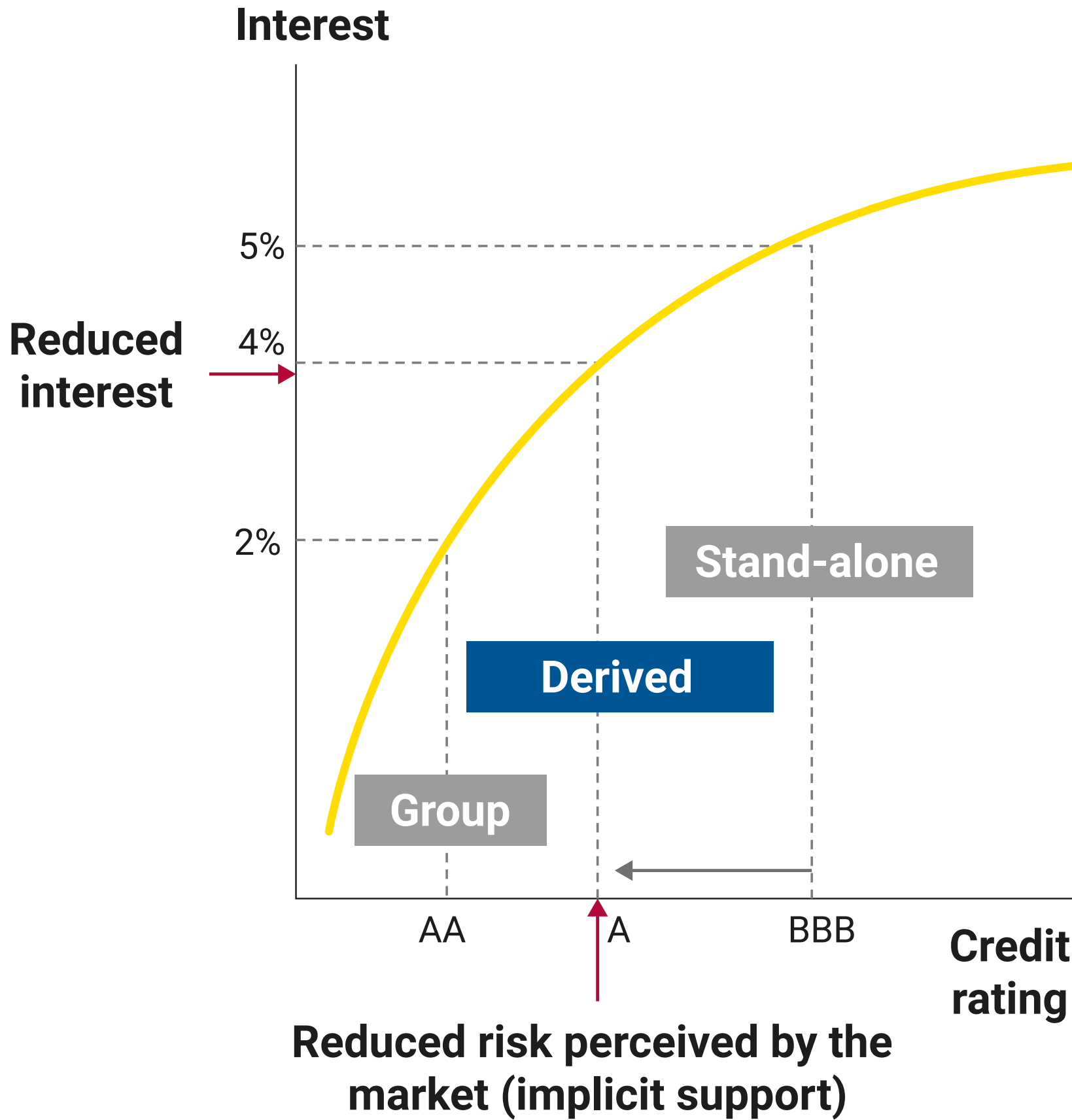
Step 3: Stand-alone rating

- Determine stand-alone rating
- Mostly quantitative input and only some qualitative factors

Step 4: Determine final credit rating

- Adjust stand-alone credit rating or adjust MNE credit rating to determine final credit rating of the borrower
- Further adjustment to the credit rating ranking of the loan (if required)

Effect of Implicit Support



- Relevant for many types of I/C financial transactions where analysis of credit rating is required
 - Loans
 - Guarantees
 - Cash pools

Arm's Length Terms and Conditions

- **Repayment date**
- **Covenants/collaterals**
- **Source of interest payments**
- **Status of lender versus other creditors**
- **Ability to obtain loan from third-party lenders**
- **Group policy (aiming for certain debt-equity ratio)**
- **Consideration of failure of the debtor to repay on the due date, etc.**

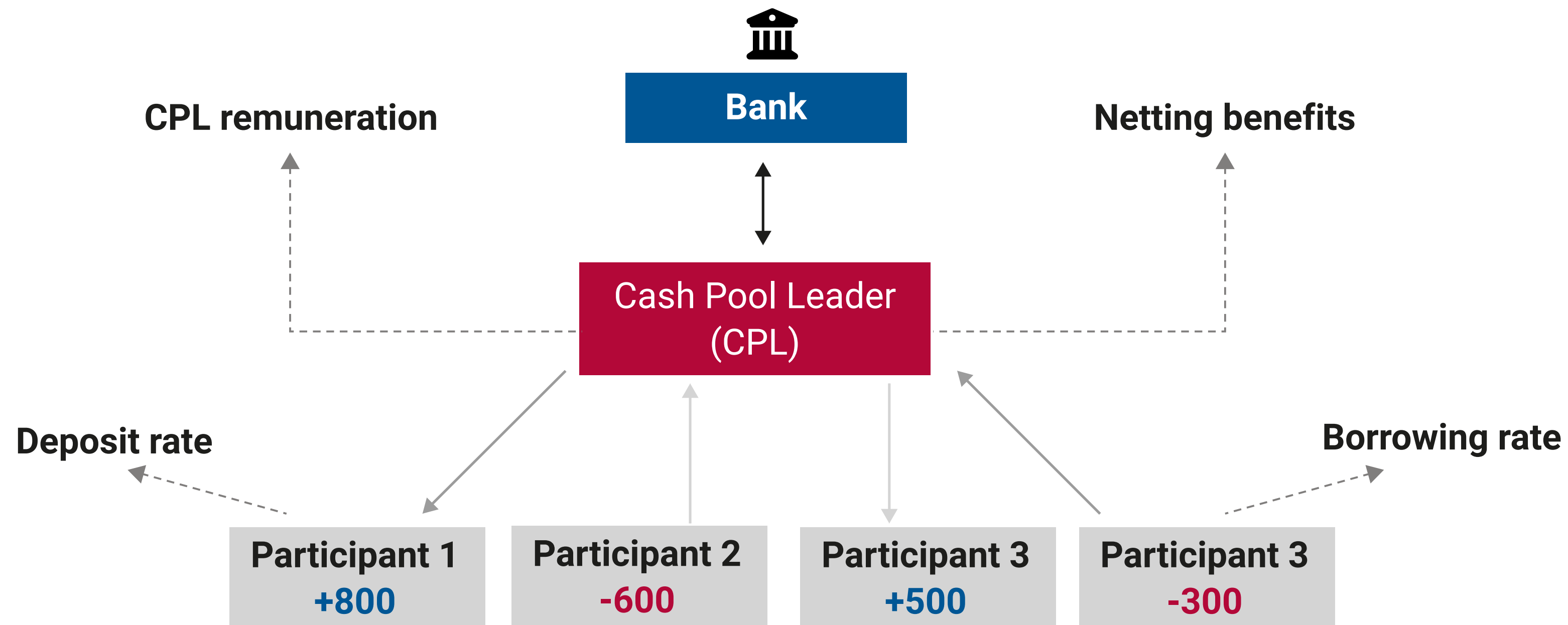
Poll Question 2

Question

In your experience, which area is the most challenging to align with treasury and other non-transfer pricing colleagues?

- A** Some loan amounts can be recharacterized as equity
- B** Bank quotes may not be considered arm's length
- C** Credit ratings of subsidiaries may not be the same as the group's
- D** Terms and conditions of intragroup loans affect the interest rate
- E** Implicit support should be taken into account

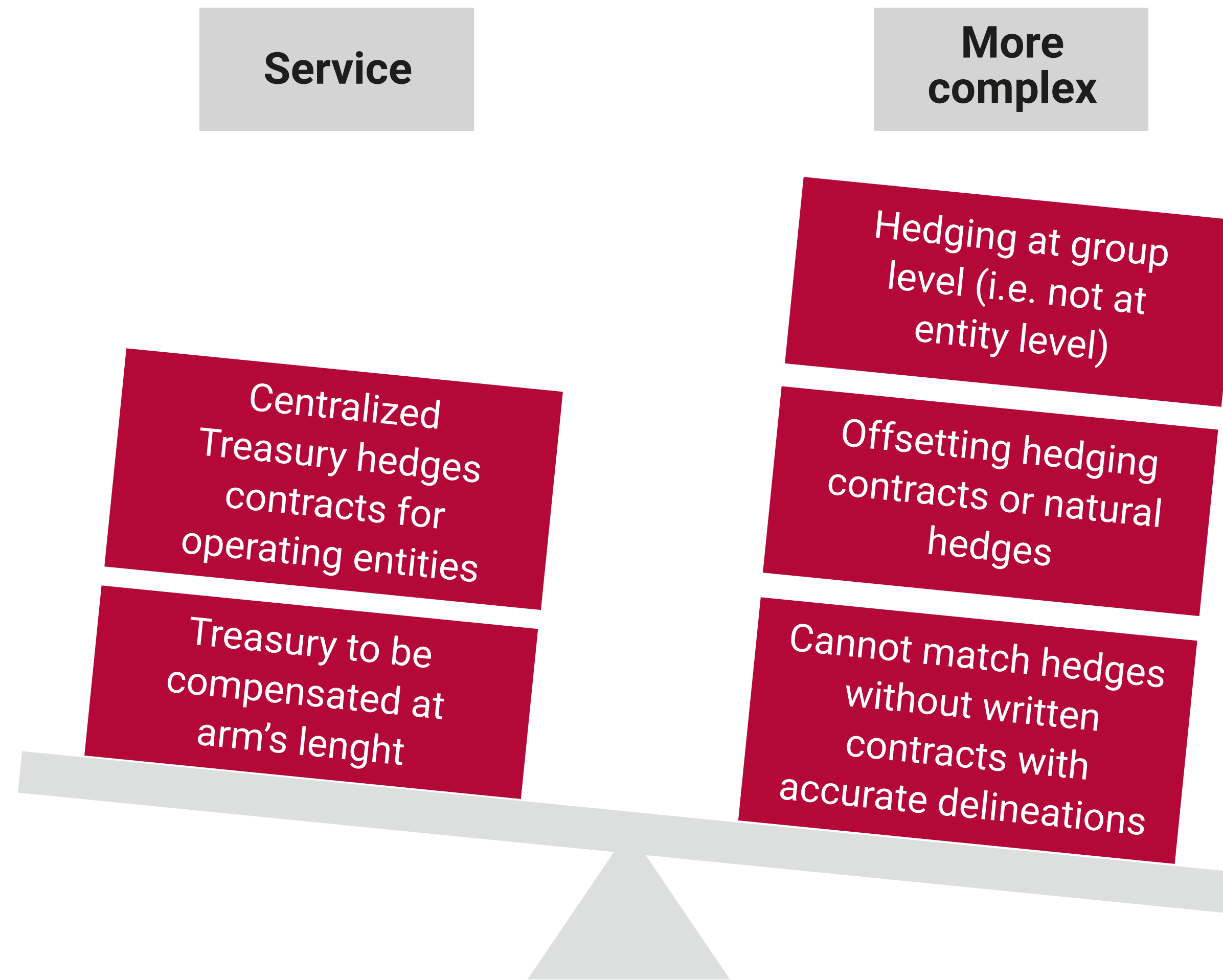
Cash Pooling: Transfer Pricing Considerations



Cash pooling is not undertaken regularly by independent enterprises: therefore, little or no data on comparables

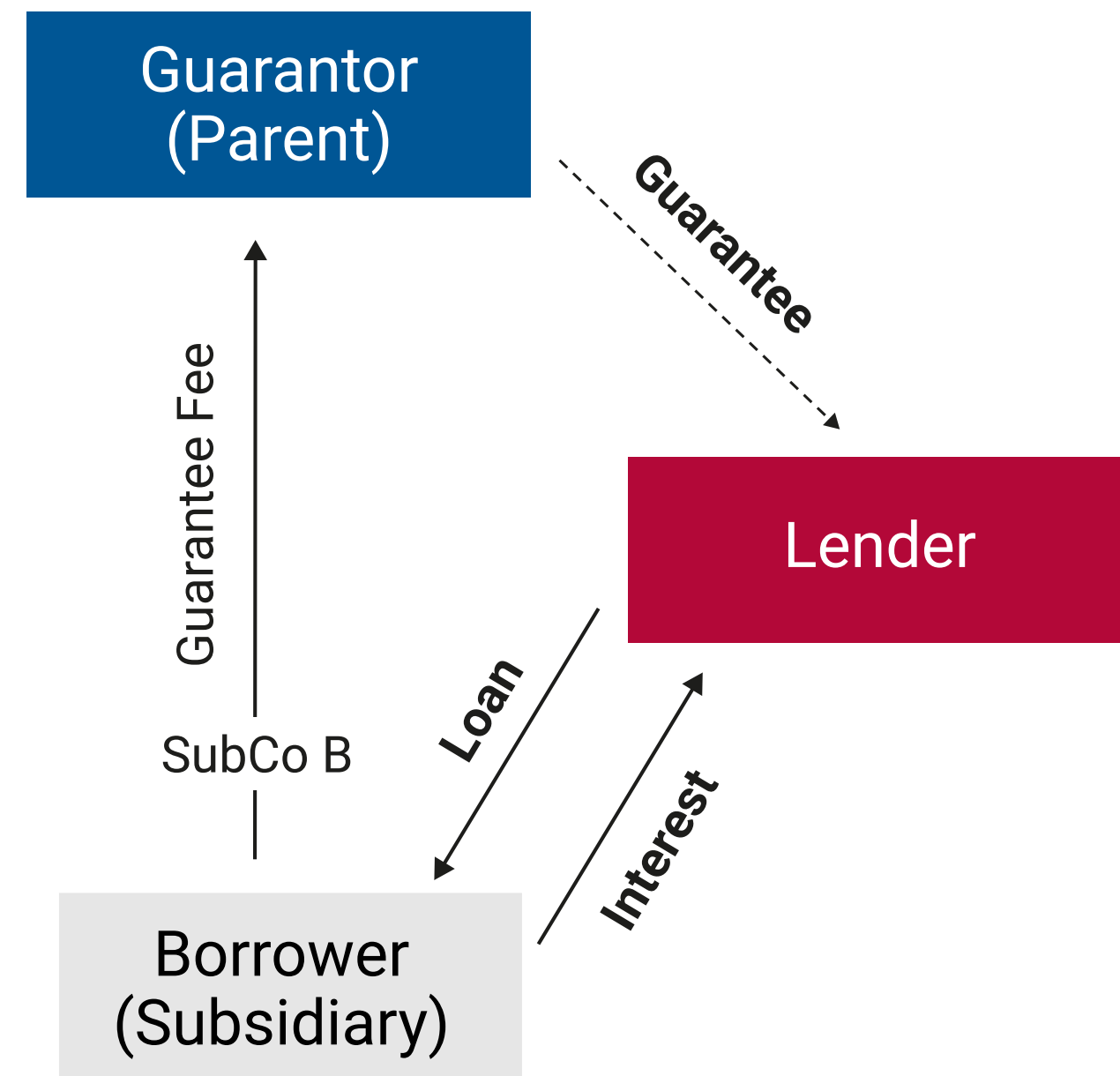
Structural long-term positions	Guarantees (e.g. cross guarantees)
Other group synergies/benefits	Credit ratings

Hedging



Limited additional guidance from the OECD

Financial Guarantee: What is It?



Delineation	Financial guarantee versus other types of obligations (e.g. "letter of comfort")
Purpose of guarantee?	<p>To charge or not to charge for financial guarantee?</p> <ul style="list-style-type: none"> > without guarantee → borrower cannot obtain loan or only a lower amount > the guarantee improves the terms and conditions of the loan (e.g. improves credit rating)?
Implicit support	No guarantee fee
Cross guarantee	Practical solution - suggestion that it does not improve the creditworthiness outside level of passive association
Pricing	CUP method, yield approach, cost approach, capital support method

Poll Question 3

Question

Which of the following is not a consequence of the application of the arm's length principle to intra-group financial transactions?

- A** Treasury/hedging activities have to be remunerated at arm's length
- B** Letter of comfort has to be compensated at arm's length
- C** Synergy benefit from cash pooling is attributed to group entities
- D** Captive insurer may not be recognized at arm's length

Concluding Remarks

- Identify and take stock of all existing intra-group financial transactions and ensure that this is regularly updated
 - Assess current transfer pricing group policies vs. key points in OECD guidance
 - Treasury practices vs. arm's length approaches – are they consistent?
 - Some common pitfalls
 - Choice of interest rate – use of bank quotes
 - Credit rating analyses
 - Group guarantees
- Documentation – transfer pricing policy clearly articulated in Master File and support documentation in Local Files

Thank *you* for your attention!

