

## **OECD releases Transfer Pricing Guidance on Financial Transactions**

On February 11, 2020 the OECD released the highly anticipated report “Transfer Pricing Guidance on Financial Transactions” (“the report”), which deals with the follow-up work in relation to Actions 8-10 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project.

### **The 2015 report on BEPS Actions 8-10**

The 2015 report on BEPS Actions 8-10 mandated follow-up work on the transfer pricing aspects of financial transactions. Under that mandate, in July 2018 the Discussion Draft on Financial Transactions was published, which aimed to clarify the application of the principles included in the 2017 edition of the OECD Transfer Pricing Guidelines (“Transfer Pricing Guidelines”). The report published by the OECD on the 11<sup>th</sup> therefore takes account of the comments received in response to the public Discussion Draft.

### **Content of the report**

Following the introduction (section A), the report focuses on the interaction with the guidance in section D.1 of Chapter I of the Transfer Pricing Guidelines, relating to the accurate delineation of controlled transactions (section B).

Subsequently, the report addresses the following specific issues related to the pricing of financial transactions:

- (i) **The treasury function** (section C), including:
  - a. Intra-group loans;
  - b. Cash pooling; and
  - c. Hedging.
- (ii) **Financial guarantees** (section D);
- (iii) **Captive insurance** (section E); and
- (iv) **Risk-free and risk-adjusted rates of return** (section F).

Sections A to E of this report are included in the OECD Transfer Pricing Guidelines as Chapter X. Section F is added to Section D.1.2.1 in Chapter I of the Guidelines, immediately following paragraph 1.106.

### **Main takeaways**

A more in-depth analysis of the report will follow. We have, however, already included some initial takeaways below.

- Our initial reading of the document is that there appear to be no big surprises compared to the Discussion Draft.

- The report thereby confirms that there is increased attention on the terms and conditions of financial transactions, meaning that there should be a thorough transfer pricing analysis as the basis for pricing such transactions.
  - In case of intercompany loans such an analysis should, for example, take into account the perspective of both the borrower and the lender and their “other options realistically available”.
- The report, in line with current practice, acknowledges that the credit worthiness of a borrower is one of the main factors which should be taken into account for the pricing of intercompany transactions. More specific, the determination of credit ratings through the use of commercial tools, which is mostly based on a quantitative analysis, is considered acceptable. However, the report stresses the importance of applying a combination of qualitative and quantitative analyses.
- The report also confirms the effect of group membership in the determination of credit ratings of MNEs which are part of an MNE group. The report explicitly states that the relative status of an MNE within the MNE group may help to determine what impact potential group support has on the credit rating of a debt issuer. Criteria that may be used to determine the status are legal obligations, operational integration and significance, shared name, potential reputational impacts, negative effects on the overall MNE group, general statement or policy or intent, and any history of support and common behavior of the MNE group with respect to third parties. We kindly refer to our article<sup>1</sup> on the impact of passive association which includes a framework for determining a credit rating (incl. the effect of group membership).
- However, the report also states that in cases where no reliable credit rating nor the effect of implicit support can be determined, it may be conditionally acceptable to use the credit rating of the MNE group as the credit rating for the MNE. However, this may only be applied in case the indicators of creditworthiness of the specific MNE do not differ significantly from those of the MNE group.

## **The report on Transfer Pricing Guidance on Financial Transactions**

The report can be accessed through the link below:

<http://www.oecd.org/tax/beps/transfer-pricing-guidance-on-financial-transactions-inclusive-framework-on-beps-actions-4-8-10.pdf>

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<sup>1</sup> <https://atlas.tax/en/news/item/470-tp-and-credit-ratings-the-impact-of-passive-association>