



OECD Financial Transactions paper

Gap analysis

Background

On 11 February 2020, the OECD issued the long awaited final version of the Financial Transactions paper (first issued as a non-consensus document in July 2018). The document evaluates the following issues:

- Delineating the transaction
- Intra-group lending
- Cash pooling
- Hedging
- Guarantees
- Captive insurance

Impact

The paper is the first to be issued by the OECD which reflects a consensus position with respect to the treatment and pricing of intercompany financial transactions. As such, companies need to assess the new guidelines (which will form Chapter X of the OECD Guidelines) against their existing group intercompany financing policy. Areas which are likely to be of greatest interest and impact include the application of implicit support, credit rating methodologies (tools and application), reconciliation against cost of external borrowing, application of the most appropriate terms and conditions for the transaction and interest rate pricing (including appropriate adjustments).

Why now?

The new Chapter will form the foundation for local application of financial transactions transfer pricing rules (in particular in territories which bring the OECD Guidelines into their local legislation directly) and also for bilateral disputes and resolution on a go forward basis. It is therefore important that companies are considering the impact now as tax authorities begin to implement and apply this new framework and the principles within. In some cases these guidelines will reflect a step change in the way groups currently approach transfer pricing for intra group financial arrangements, requiring significant overhauls of their policies for such arrangements.

Alongside the new OECD chapter, the abolition of LIBOR in 2021 is prompting businesses to review their external and internal financing arrangements and so there is opportunity to concurrently address the LIBOR abolition alongside bringing intra group policies into line with the Guidelines.

Why PwC?

We have extensive experience having worked with a wide variety of groups on assessing their financial transactions transfer pricing policies and shaping practical, sustainable, defendable solutions, in particular in areas such as:

- Defining a group credit scoring policy for loan/guarantee pricing purposes, taking into account implicit support and sovereign credit rating nuances
- Developing pricing grids/frameworks which allow flexibility for duration, credit rating, currency etc. for intercompany group loan and guarantee pricing
- Determining the key terms, conditions and covenants to be included in intercompany legal agreements (and reflecting market changes such as the upcoming LIBOR replacement)
- Shaping cash pooling, hedging and captive insurance policy frameworks taking into account the functional activities, underlying risks and assets at risk
- Supporting with the implementation (including legal support), documentation (including for Master File purposes) and defence of such arrangements.



How can we help?

The most important first step for companies will be to analyse their existing financial transactions transfer pricing policy against the new OECD framework. We will collaborate with you to perform a desktop assessment of your existing policy and risk assess which areas need immediate remediation, along with providing recommendations as to potential options for adapting your existing approach.

4. Intragroup Financing Policy Gap Analysis

4.1 Intragroup loan policy

Area	Current policy	Summary of guidance	Is policy in line?	Gaps	Priority (existing loans)	Priority (prospective loans)
Accurate delineation of transaction	Policy does not consider the delineation of the transaction i.e. thin capitalisation considerations.	The guidance provides details on how to delineate intragroup financing between thin capitalisation debt and equity. In doing so relevant consideration should be given to the nature of the borrower, purpose of the loan, ability of the borrower to repay the loan and various other factors.	No	For each loan, consideration of the relevance of delineation under relevant legislation should be undertaken. If relevant, work should be undertaken to analyse the transaction and provide documentary evidence on the conclusion that this may not be relevant for certain jurisdictions.	M	H
		The following example of UK Transfer Co Ltd supports the continued receipt of the full income associated with its lending activity. This should be monitored on an ongoing basis.	No	L	L	
Consideration of options realistically available to each party	No consideration currently made/documentated	Each party would be expected to consider the options realistically available to its arm's length and enter into transactions if there is no better option to meet their commercial goals.	No	In practice focus should be on the options available to the borrower. Consideration should be given to the purpose of the debt and use of funds rather than merely the capacity to take on the debt.	L	H

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4.2 Cash pooling arrangements

Area	Current policy	Summary of guidance	Is policy in line?	Gaps	Priority
Structure of cash pool arrangements	Interest rates on internal balances mirror those on the external balances.	Consider focus on service models; discuss ways to remunerate cash pool members for benefits (liquidity pooling, risk diversification, etc.) which can align with cash and hybrid models than with entrpreneurial models. Suggests importance of functional analysis for participants (header).	No	The current policy neither seeks to appropriately reward the cash pool leader or ensure appropriate share of benefits to cash pool participants. An exercise should be undertaken to review this position including consideration of the functional analysis of the cash pool leader and whether a service or entrepreneurial model should be applied.	M
Characterisation of cash pool header	No review of balances to identify exceptions by size/duration	Consideration of whether participants who maintain long or short positions should be characterised as loans instead of cash pooling transactions	No	An exercise should be undertaken to review the nature of the cash pool header and its term balances. Ongoing controls to be implemented to identify such balances and to plan to extract these from the pool proactively.	H
Cross guarantees	No guarantees fees charged for cash pool cross guarantees	Cross-guarantees are inherently required, but since there may be no incremental changes to the creditworthiness of the participants, no compensation is required.	Yes	None	L

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