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OECD on transfer pricing of financial transactions (2) (2/41/18)

This article wraps up our recent series on this topic.

Intragroup loans

The draft raises questions and proposes novel approaches to the allocation of risk-related returns, offering concepts that consider a two-sided analysis of borrower and lender and going beyond contractual terms to alternatives and the actual management of risks. The draft also includes important guidance on the core aspects of intragroup loan pricing:

- *Use of credit ratings.* The OECD notes the importance of credit ratings and describes a number of possible approaches to estimating a borrower's credit rating. The OECD also notes some of the weaknesses of commercial rating tools but does not preclude their use.
- *Effect of group membership.* The draft states that in some circumstances it will be appropriate to calculate a credit rating for an intragroup borrower purely based on its stand-alone circumstances. In other cases, however, it will be appropriate to assume that a group would support its subsidiaries in the absence of a formal guarantee (so-called implicit support from passive association) and to adjust the credit rating accordingly.
- *Pricing approaches.* The draft provides insights into three pricing approaches (comparable uncontrolled price, cost of funds, and bank letters/opinions) to be considered for intragroup loans. The draft states that bank quotes should generally not be accepted as reliable evidence of arm's length pricing, and notes limitations in the cost of funds approach.

The OECD's comments are again important to Latvian companies within an MNE group since they will need to rethink their current approach to credit ratings or revise their current pricing methodology.

Cash pooling

The draft states that cash-pool arrangements create synergies or savings for a group because they potentially eliminate the spread that banks charge between depositing and borrowing rates. The OECD states that such savings typically result from a concerted effort made by all the members, and focuses its guidance on how those synergies should be shared between the cash-pool leader and participants. The draft states that in most instances it will not be appropriate for the cash-pool leader to retain a significant part of those savings.

The draft then discusses three mechanisms for sharing cash-pool synergies between participants:

- *Enhancing the interest rate for all participants*. This would provide the members with more sizeable balances in the pool (positive or negative) and more favourable rates, resulting in some of the benefit being automatically allocated to such participants through the interest rates applied.
- *Applying the same interest rate to all participants*. In this case the debit and credit balances would receive the same interest rate.
- *Allocating cash-pool benefits to the depositors.* They take a genuine credit default risk since their capital is effectively at risk.

The OECD's comments will be relevant to all MNE groups that operate a cash-pool structure, in particular groups whose cash-pool structures allocate a significant spread to the cash-pool leader.

Key takeaways

This being a non-consensus discussion draft, a number of changes may occur before guidance is formally released. However, the paper provides an insight into the direction of the OECD's thinking.

Since intragroup financial transactions continue to be a high-focus area in transfer pricing, taxpayers are advised to review their existing transfer pricing policies in the light of this publication and to ensure that appropriate evidence and supporting documentation are in place for their intragroup financial transactions.