TAXAND

VIRTUAL TRAINING TUESDAY

Financing the Group: Navigating Transfer Pricing for Loans & Guarantees

24 June 2025

Your global tax partner

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OUR OBJECTIVES TODAY

- ✓ Grasp how the OECD’s Chapter X applies to real-world intragroup financial arrangements
- ✓ Tackle key technical and valuation challenges in loans, guarantees, and cash pooling
- ✓ Find out how different countries are implementing the guidance and where audit risks are growing
- ✓ Learn from practical case studies and engage in a live expert-led discussion

AGENDA

OVERVIEW OF OECD'S CHAPTER X AND DETAILED DISCUSSION OF KEY CONCEPTS

FOCUSED SEGMENTS ON THE TRANSFER PRICING TREATMENT OF INTRAGROUP LOANS AND GUARANTEES

ANALYSIS OF VALUATION APPROACHES AND RISK CONSIDERATIONS

DISCUSSION OF PRACTICAL CHALLENGES IN IMPLEMENTING LOCAL GUIDANCE AND NAVIGATING DOCUMENTATION REQUIREMENTS

PRACTICAL CASE STUDIES TO ILLUSTRATE THE APPLICATION OF THE GUIDANCE

INTERACTIVE DISCUSSION AND Q&A TO DEEPEN UNDERSTANDING AND EXCHANGE VIEWS

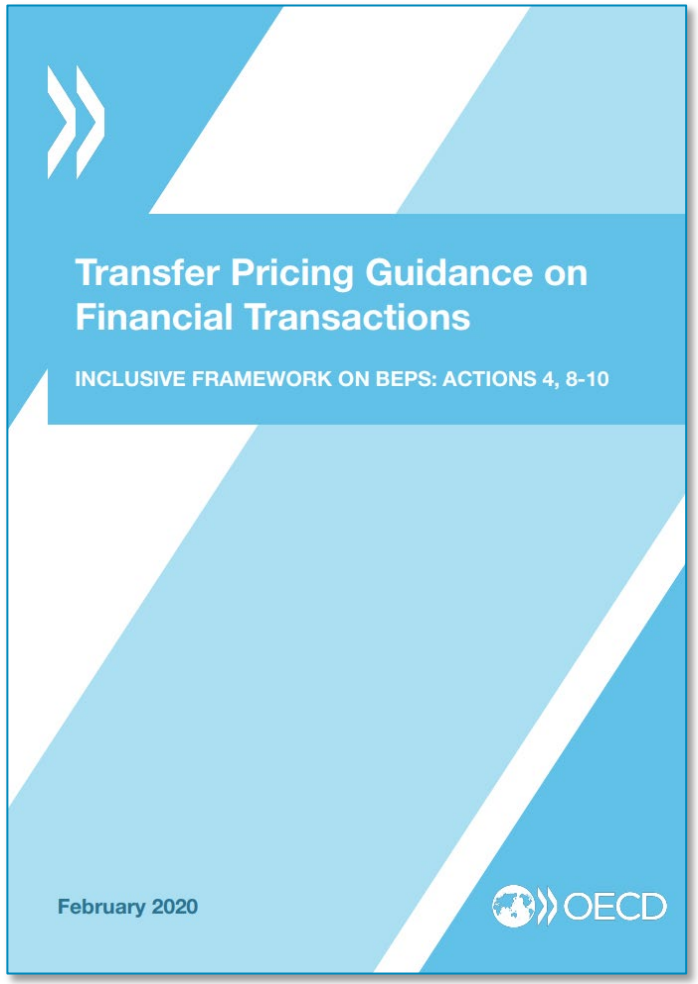
INTRODUCTION

INTRODUCTION

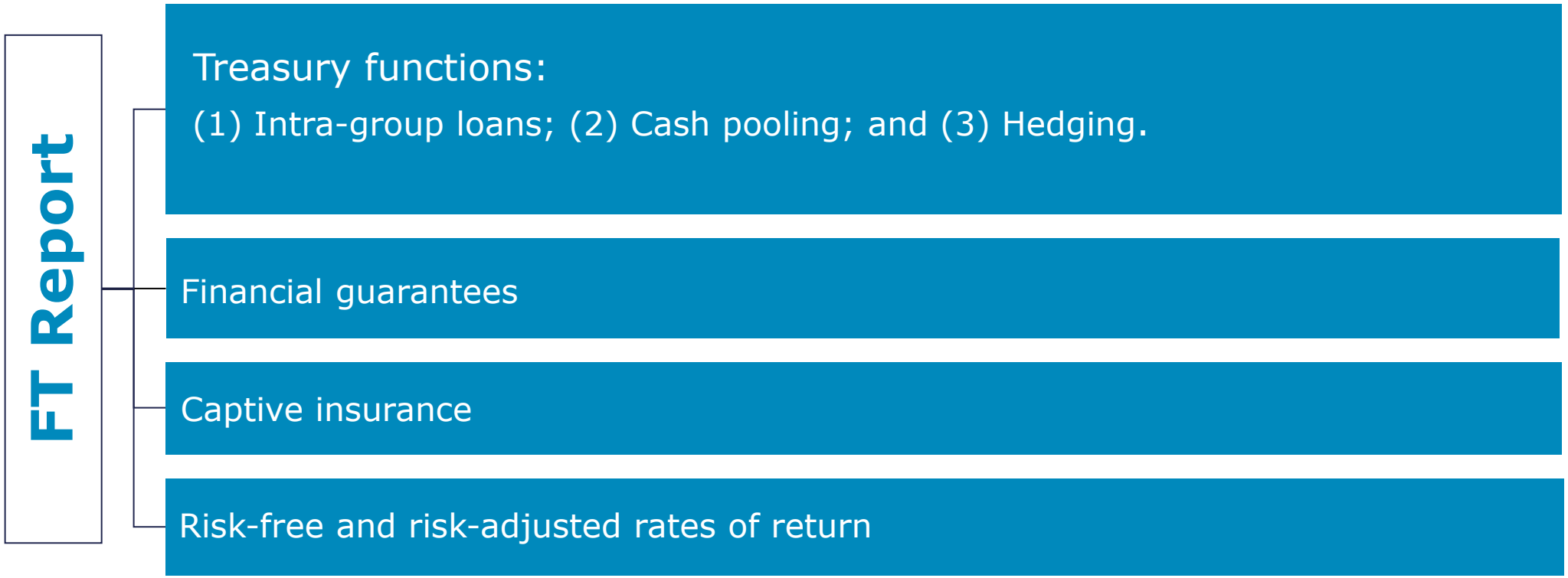
- February 2020: New Chapter X of the 2022 OECD Guidelines as part of the BEPS outcomes (**FT Report**)

- **3 key concepts**:
  1. Accurate delineation of transactions;
  2. Control over risk; and
  3. Financial capacity

- TPG tend to "apply" **retroactively** to existing transactions, creating significant exposure to transfer pricing disputes and double taxation



FT REPORT OVERVIEW



PURPOSE OF THE FT REPORT

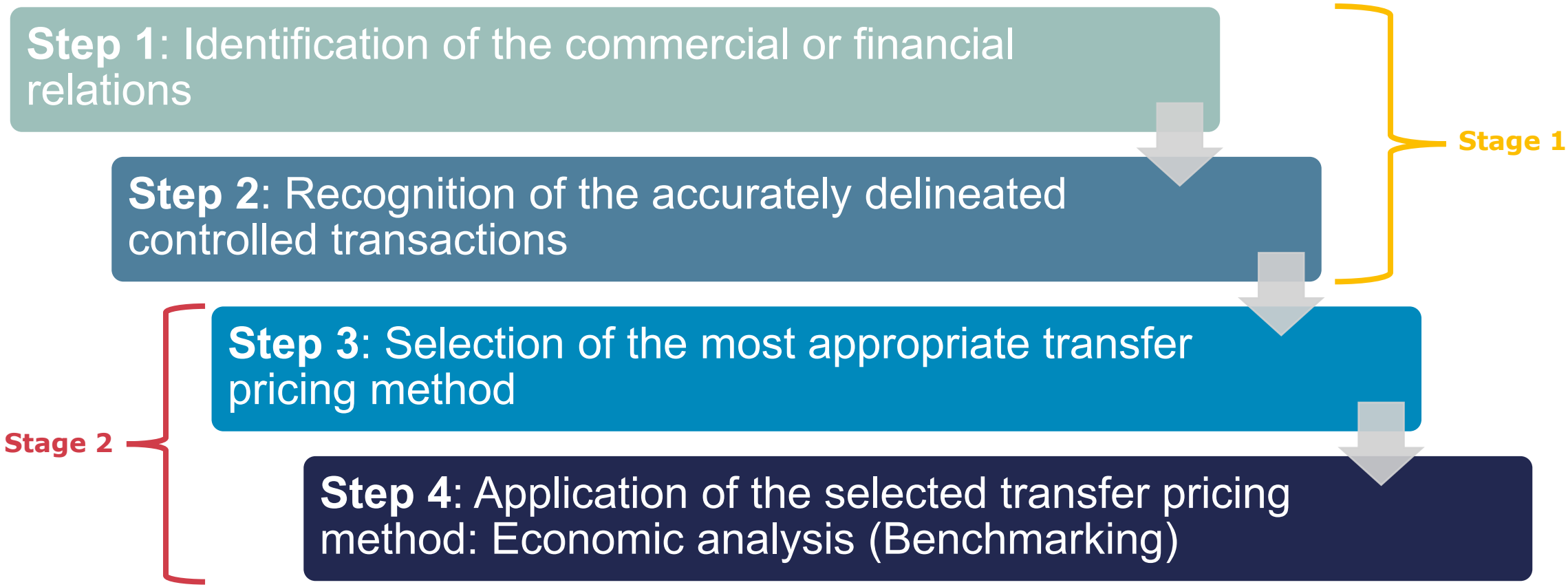
Loans	• Cash rich companies with lack of substance • Unusual contractual terms leading to high interest rates
Cash pools	• High returns to cash pool leaders but little activity • Participants leaving balances in the pool long term
Treasury Centres	• Interest income in treasury centres with limited substance
Captives	• Typically used to shift profits to low or no tax jurisdictions, but not truly insurers
Guarantees	• High guarantee fees and enhancement of debt quantum

2022 OECD TPG CHAPTER X: TP ASPECTS OF FINANCIAL TRANSACTIONS

Chapter X

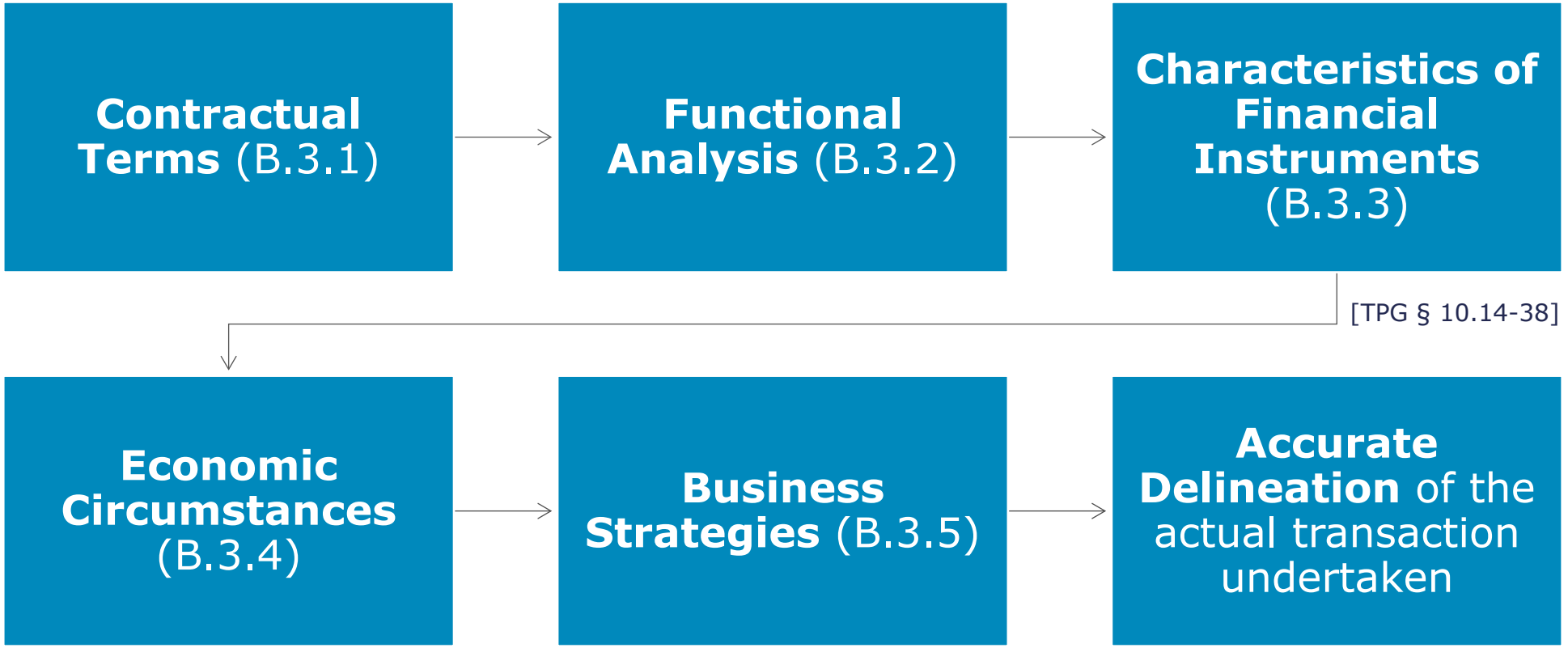
- Treasury functions
  - Intra-group loans
  - Cash pooling
  - Hedging
- Financial guarantees
- Captive insurance

APPLICATION OF THE ALP–4 STEP APPROACH

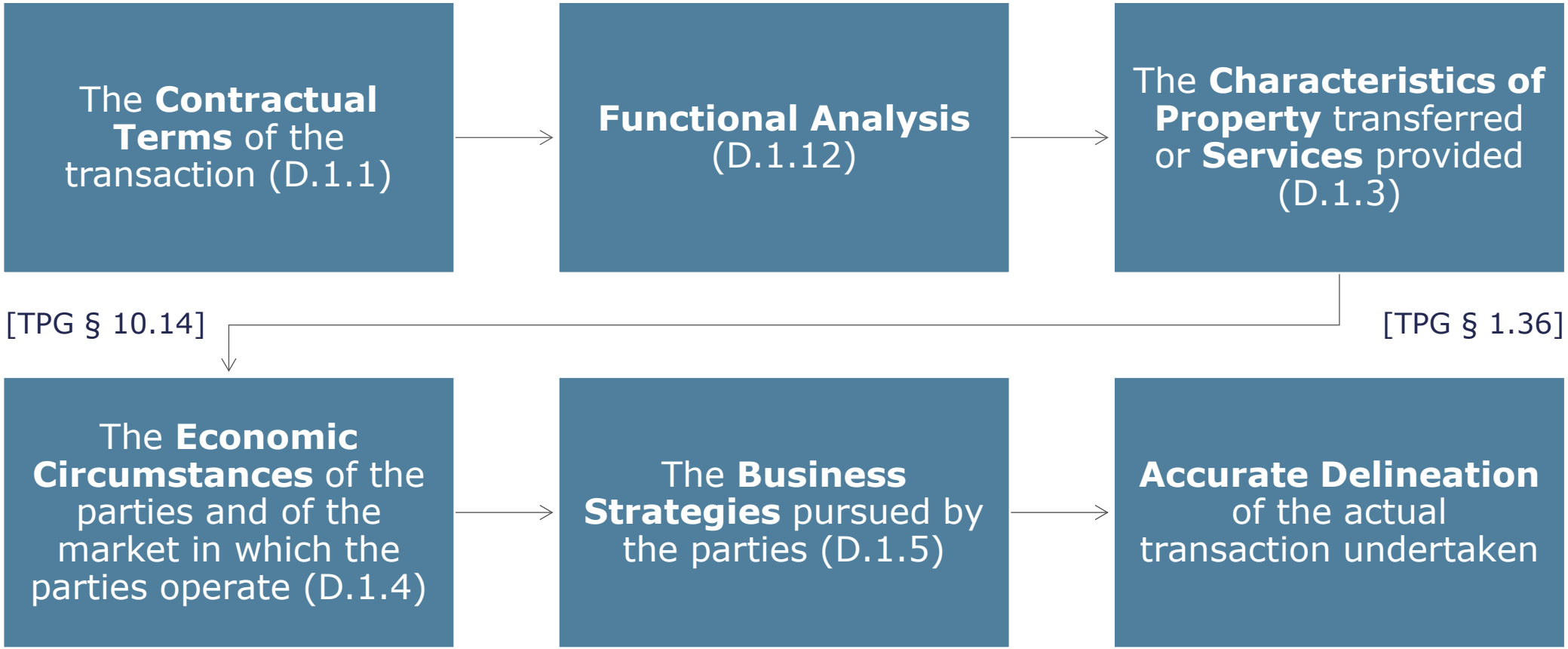


STEP 1: IDENTIFICATION OF THE COMMERCIAL OR FINANCIAL RELATIONS

CHAPTER X: IDENTIFYING THE COMMERCIAL OR FINANCIAL RELATIONS



IDENTIFYING THE COMMERCIAL OR FINANCIAL RELATIONS
(SECTION D.1. OF CHAPTER I OF THE TPG)



CONTRACTUAL TERMS

- Usually explicitly stated in a **written agreement**
- However, between associated enterprises the contractual arrangements may not always provide information in sufficient detail or may be inconsistent with the actual conduct of the parties or other facts and circumstances
- Look to other documents and the actual conduct of the parties
- **Substance over form approach**

FUNCTIONAL ANALYSIS: FROM BOTH PERSPECTIVES
(I.E. LENDER AND BORROWER)

Key Functions performed by the Lender

[TPG § 10.23-24]

- Analysis and evaluation of the risks inherent in the loan
- Capability to commit capital of the business to the investment
- Determining the terms of the loan
- Organising and documenting the loan
- Ongoing monitoring and periodic review of the loan
- Determining the creditworthiness of the borrower

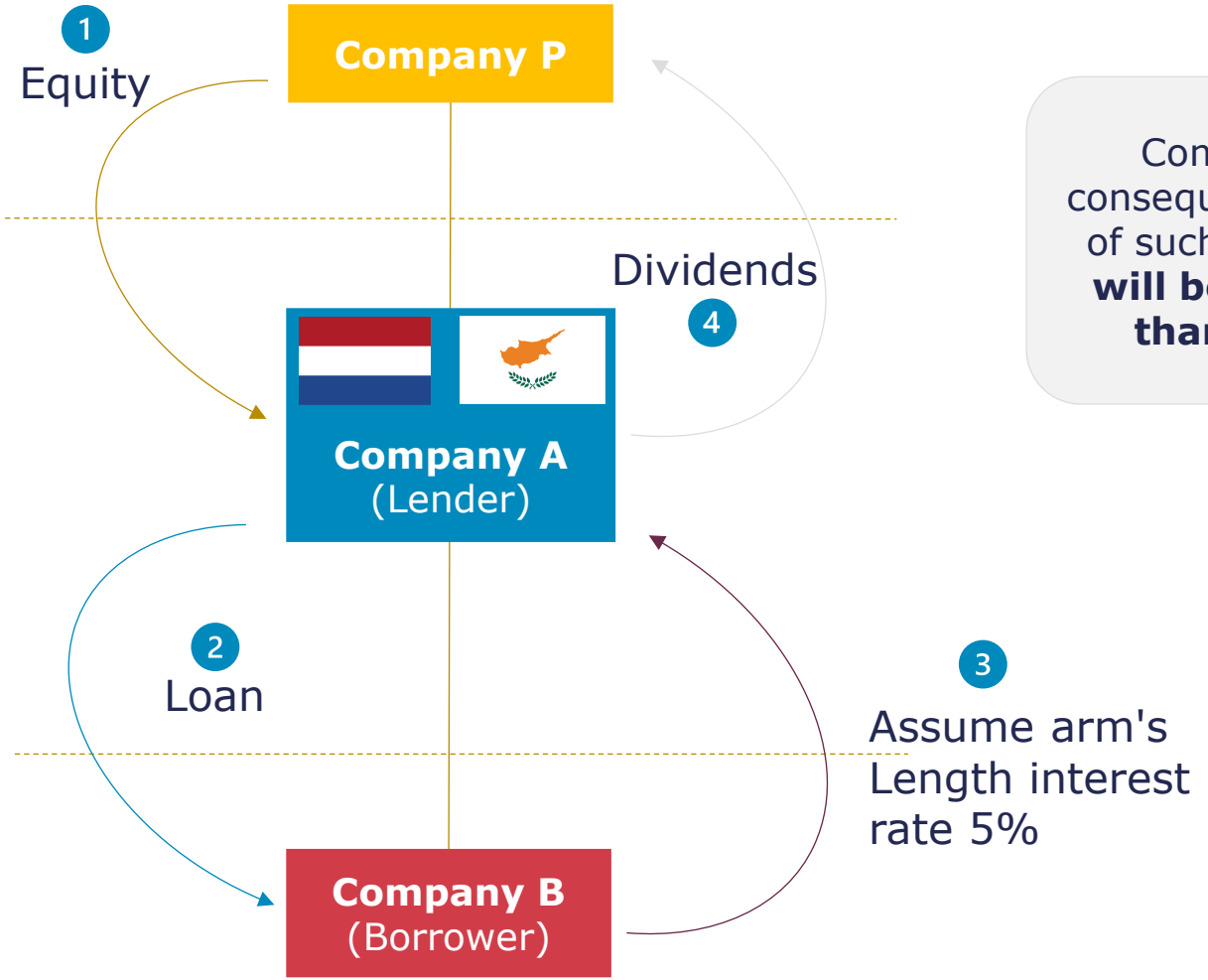
Key Functions performed by the Borrower

[TPG § 10.26]

- Ensuring the availability of funds to repay the principal and the interest on the loan in due time
- Providing collateral, if needed
- Monitoring and fulfilling any other obligation derived from the loan contract

FINANCING COMPANY: RISK-FREE RETURN EXAMPLE

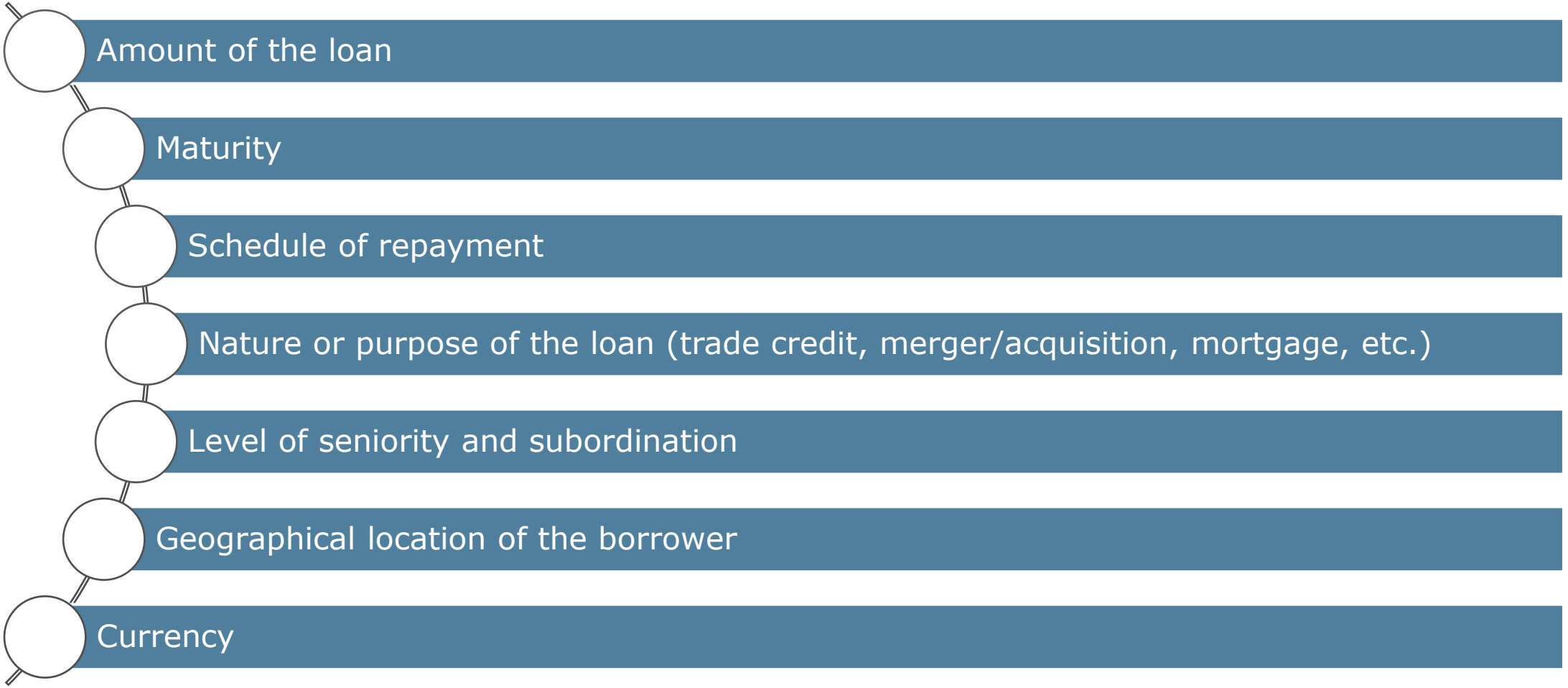
- Accurate delineation of the actual transaction indicates that **Company A** does not exercise control functions related to the advance of funds
- But that **Company P**, the parent company of the MNE group, is exercising control over those risks, and has the financial capacity to assume such risks.



Company P will bear the consequences of the playing out of such risks and **Company A will be entitled to no more than a risk-free return**

[OECD TPG § 10.25]

CHARACTERISTICS OF FINANCIAL INSTRUMENTS



[TPG § 10.28-29]

ECONOMIC CIRCUMSTANCES

Differences That Material Affect Prices

Important Factors:

- Currencies
- Geographic locations
- Local regulations
- Business sector of the borrower
- Timing of the transaction

Macroeconomic Trends:

- Central bank lending rates or interbank reference rates,
- Financial market events like a credit crisis, can affect prices

Precise timing of the issue of a financial instrument is crucial

Multiple year data on loan issuances will **not** provide useful comparables

[TPG § 10.30-33]

BUSINESS STRATEGIES

- Different business strategies can have a significant effect on the **terms and conditions** which would be agreed between independent enterprises

- For example, independent lenders may offer loans with **different terms** for a business undergoing a merger or acquisition

- The analysis of the business strategies will also include consideration of the MNE group's global financing policy, for example Company A provides a 10-year loan to Company B for short-term working capital. However, given AB Group's policy of using one-year revolving loans for such purposes, the transaction would be accurately delineated as a one-year revolving loan. Therefore, pricing should reflect a series of one-year revolving loans rather than a 10-year loan.

TREASURY FUNCTIONS

- The treasury structure of an MNE group varies based on its complexity and operations. **Decentralized structures or centralized treasury.**

- A key function of corporate treasury is to **optimize liquidity** across the MNE group, ensuring **sufficient cash availability** in the **right location** and **currency**.

- Treasury's role in financial risk management helps identify and address risks, **optimizing the cost of capital** for the benefit of the MNE group.

- Treasury may also be responsible for **raising debt** through bonds or loans, **raising equity**, and **managing relationships with external bankers** and independent credit rating agencies

TWO CASES WHERE TREASURY ACTIVITIES FALL UNDER THE SERVICE MODEL CATEGORY

- **The first case:** The treasury function supports the MNE group's commercial operations by optimizing financing efficiency. It is typically a **support service**, such as **cash pool leader**, and may be treated as an **intra-group service**, with pricing guidance from Chapter VII

[TPG § 10.45]

- **The second case**: The treasury may **centralize** the MNE group's external borrowing and provide **intra-group lending**. In such cases, the treasury should receive an arm's length fee for its coordination activities, following guidance from Chapter I, paragraph 1.188

[TPG § 10.46]

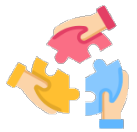
STEP 2: RECOGNITION OF THE ACCURATELY DELINEATED CONTROLLED TRANSACTIONS

INTERACTION WITH OTHER ANTI-AVOIDANCE RULES

- Chapter X states that "*this guidance is not intended to prevent countries from implementing approaches to address the balance of debt and equity funding of an entity and interest deductibility under domestic legislation*".

[TPG §10.09]

- Consequently, other approaches may be applicable such as:



  - **Earning stripping** rules (OECD via BEPS Action 4 or ATAD Article 4);
  - **Thin capitalisation** rules;
  - Domestic – **General Anti-Avoidance Rule** (GAAR); and
  - Tax Treaty – **OECD Model A11(6) regarding excessive interest** & **Principal Purpose Test.**

DETERMINATION OF WHETHER A PURPORTED LOAN SHOULD BE REGARDED AS A LOAN (OR EQUITY)

- Commentary to Article 9 of the OECD Model Tax Convention notes in paragraph 3(b) that Article 9 is relevant
  - "**not only** in determining whether the **rate of interest** provided for in a **loan** contract is an arm's length rate, but also whether a prima facie loan can be **regarded as a loan** or should be regarded as some other kind of payment, in particular a **contribution to equity** capital".

[TPG §10.05 & §10.10]

- Guidance on non-recognition (Section D.2 of Chapter I) also be relevant

[TPG § 10.06]

- Accurate delineation of the actual transaction under Chapter I will precede any pricing attempt

[TPG § 10.11]

  - Caveat §C.1. Intra-group loans applies in determining whether interest rate in a loan contract is arm's length, assuming the transactions are recognized as loans under Chapter I or relevant domestic laws.

TAX AUTHORITIES CAN EITHER NOT RECOGNISE OR RE-CHARACTERISE AN INTRA-GROUP LOAN

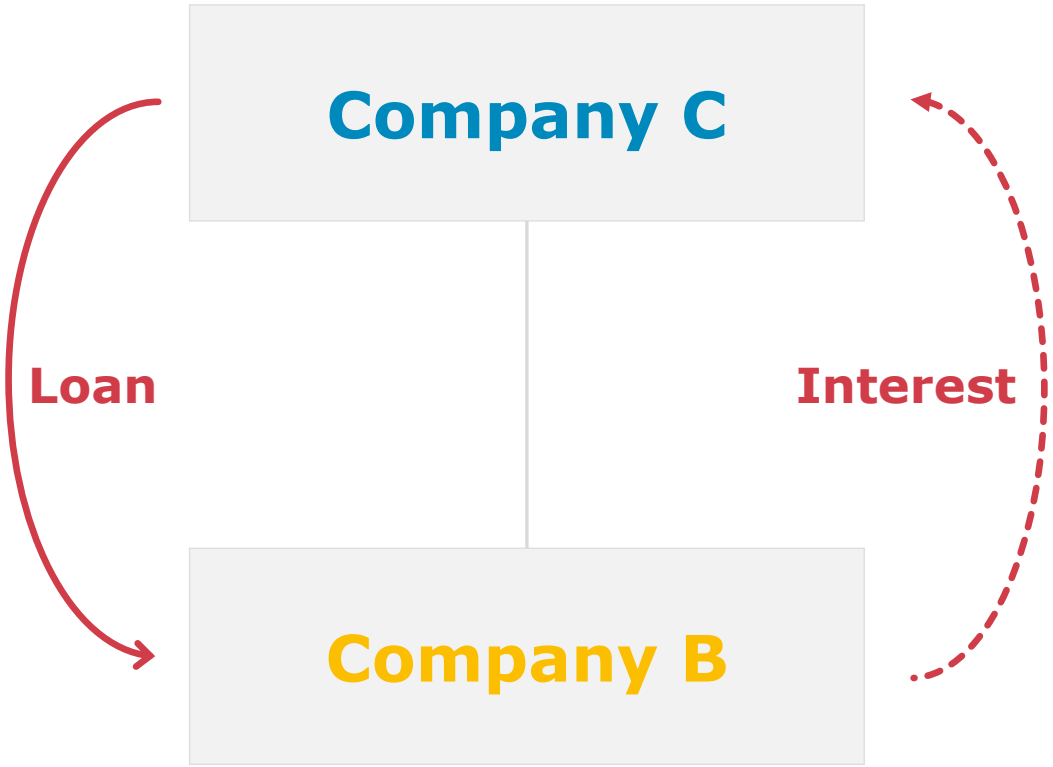
- In case the transaction is found to be **commercially irrational** then the tax authorities may **disregard** the transaction and therefore **disallow the interest expense**.

[TPG §10.08]

- The same result would be achieved in case the tax authorities decide to **re-characterise** the transaction/payments thereunder, normally from **interest to dividends**.

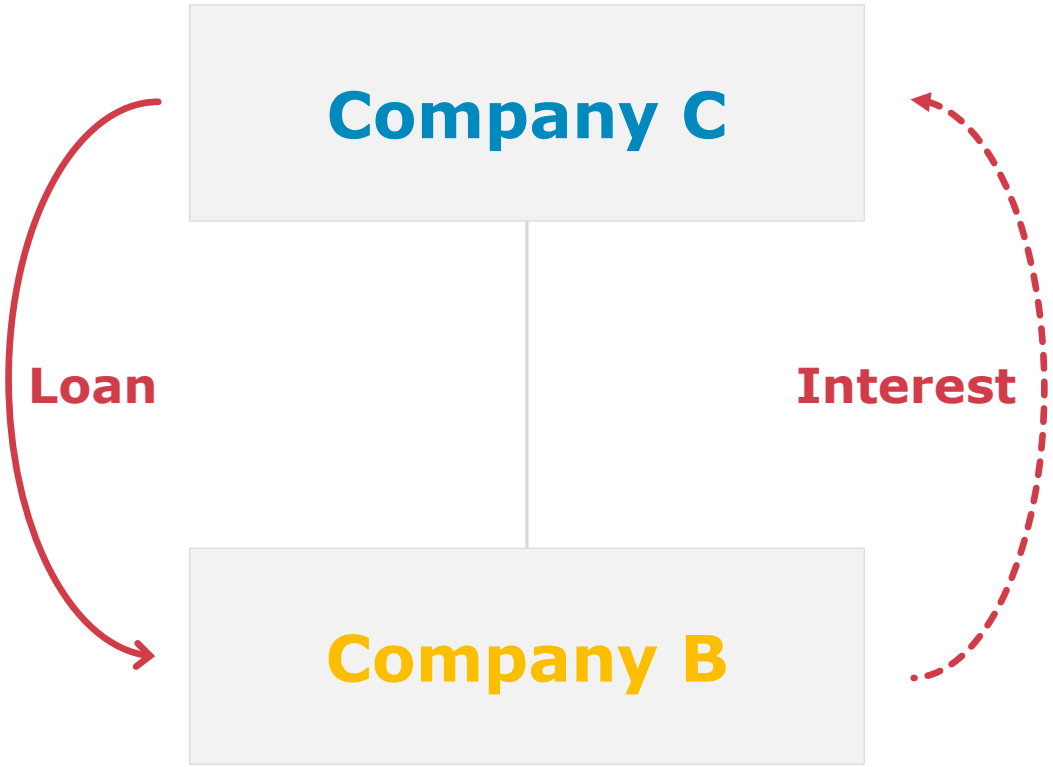
- The generally **lower tax treaty rate** for interest income (i.e. Article 11 of the OECD Model) **would not apply**, and therefore the source country will have an unlimited taxing right to apply its domestic withholding tax rate imposed on interest paid to non-residents.

PRACTICAL EXAMPLE: LOAN VS EQUITY CONTRIBUTION (FACTS)



- **Company B**, a member of an MNE group, needs additional funding for its business activities.
- **Company C** lend money to **Company B** which is denominated as a loan with a term of 10 years.
- Projections of **Company B** for the next 10 years, it is clear that **Company B** would be unable to service a loan of such an amount.
- An unrelated party would not be willing to provide such a loan to **Company B** due to its inability to repay the advance.

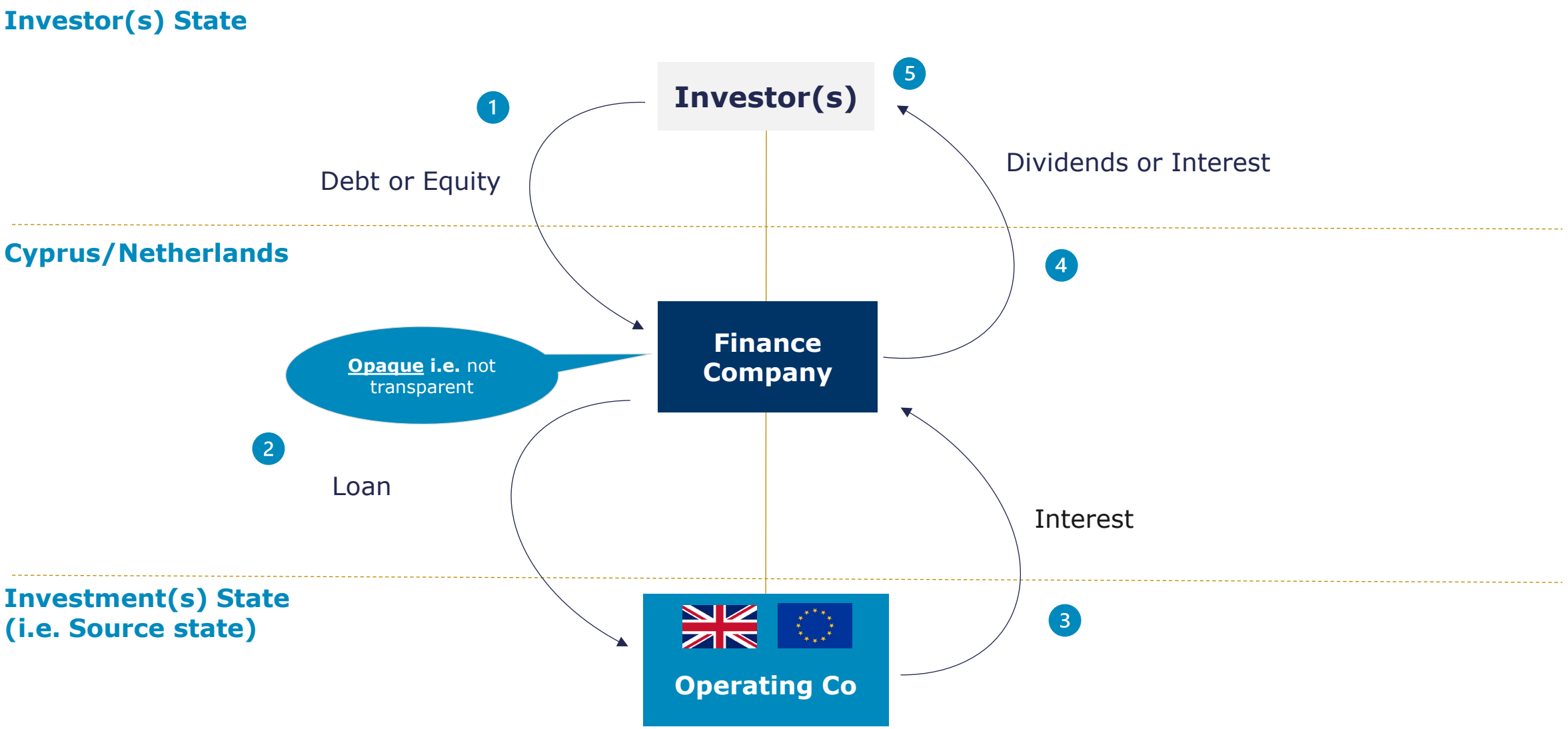
PRACTICAL EXAMPLE: LOAN VS EQUITY CONTRIBUTION



- Accordingly, the accurately delineated loan amount from **Company C** to **Company B**, for transfer pricing purposes, is determined by the maximum amount an unrelated lender would offer and an unrelated borrower would accept, considering the possibility of no loan being made.

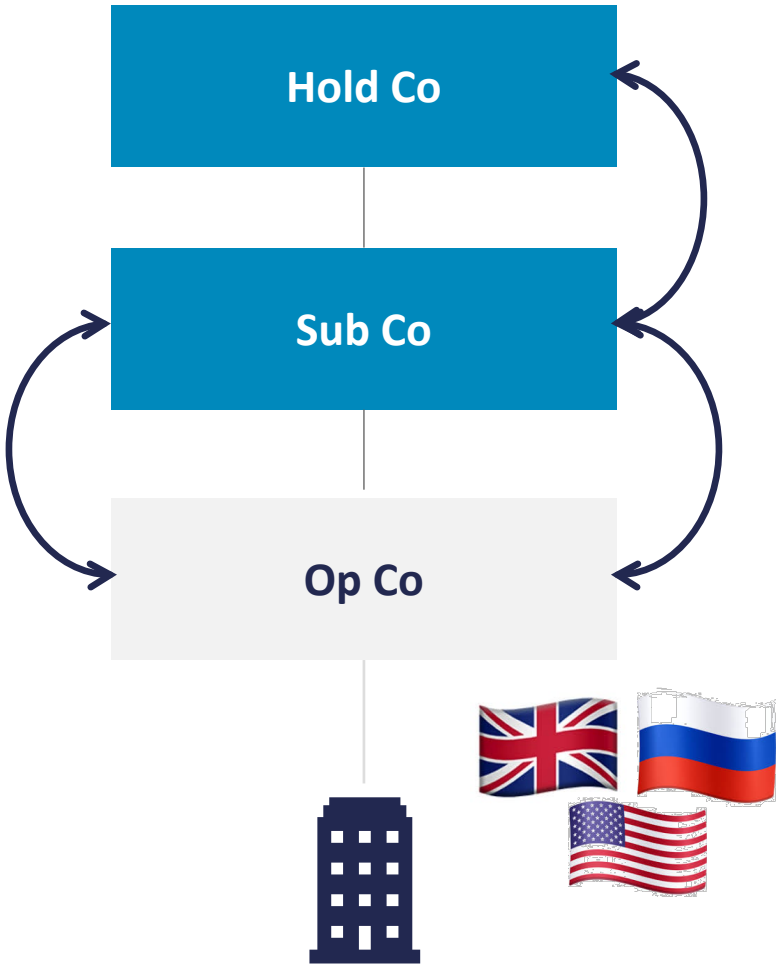
- Consequently, the remainder of **Company C's** advance to **Company B** would not be delineated as a loan for the purposes of determining the amount of interest which Company B would have paid at arm's length.

BASE CASE: FINANCE COMPANY STRUCTURE



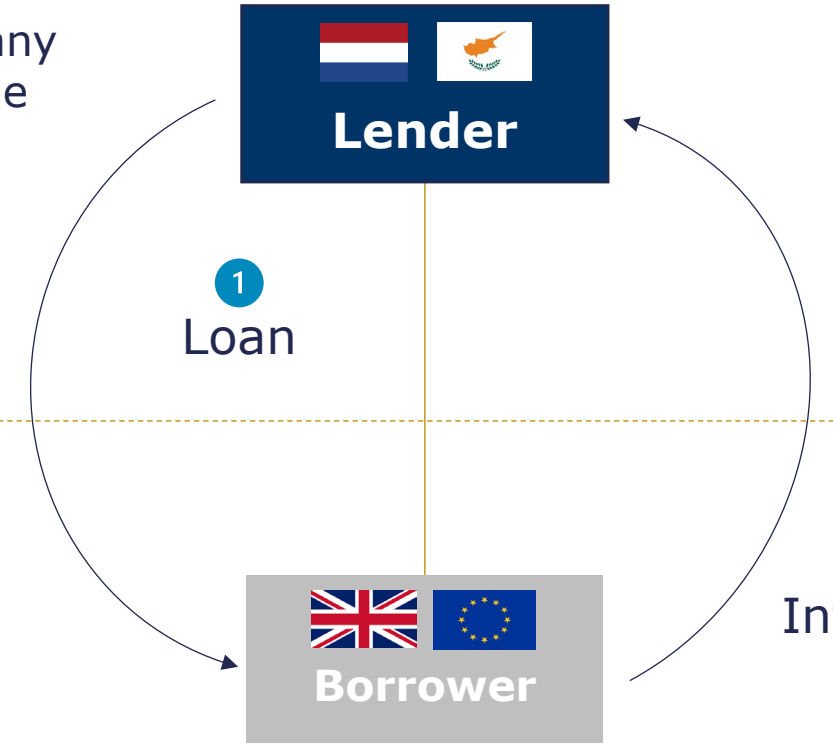
BACK-TO-BACK ARRANGEMENTS: TWO LINES OF DEFENSE

- **Source country (Op Co)** can tax the income (i.e. interest expense) paid to non-residents in two ways:
- Impose a WHT; and
- Denying a deduction for payments to non-residents



FINANCE COMPANY STRUCTURE: "INBOUND" INTEREST

Interest-free intercompany loans shift income from the lender's country to the borrower's country



Inbound Interest: Tax Treatment of interest received by residents of a country from non-residents (e.g. payments received by a Cyprus Company)

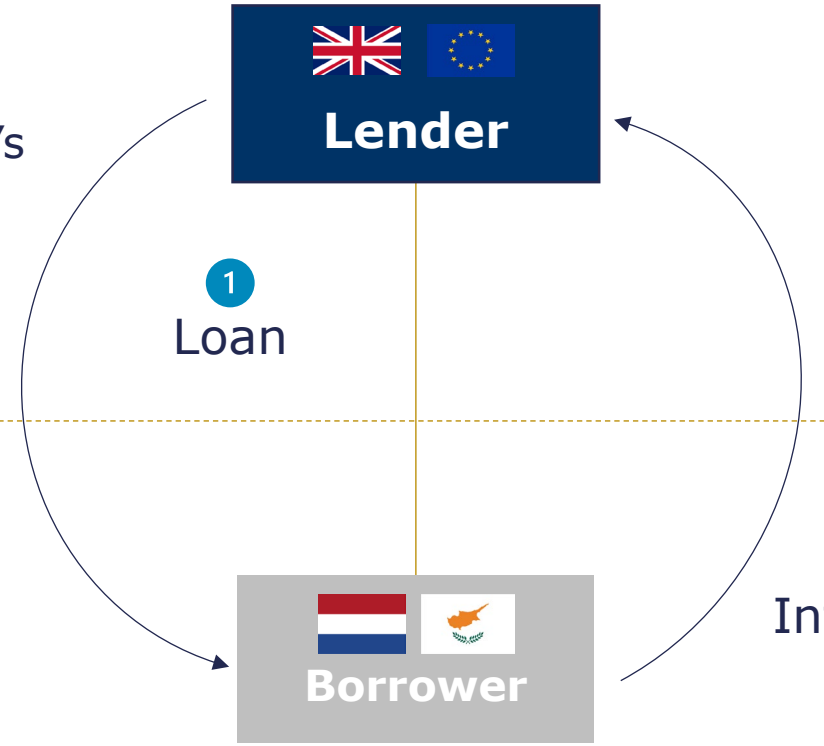
State R (i.e. Resident State)

State S (i.e. Source state)

The fundamental **symmetry** between the treatment of cross-border interest income and expenses means that every payment of cross-border interest inevitably raises questions both about whether the **payment is deductible by the payer** and whether the payment is **included in the income of the recipient.**

FINANCE COMPANY STRUCTURE: "OUTBOUND" INTEREST

Excessive interest on intercompany loans shifts income from the borrower's country to the lender's country

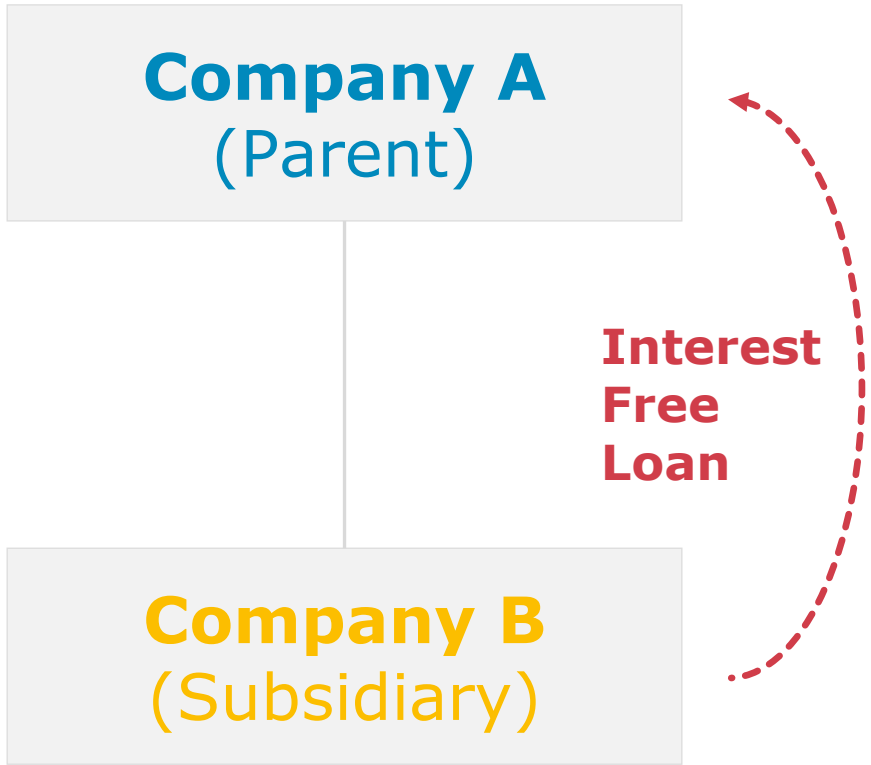


State R (i.e. Resident State)

State S (i.e. Source state)

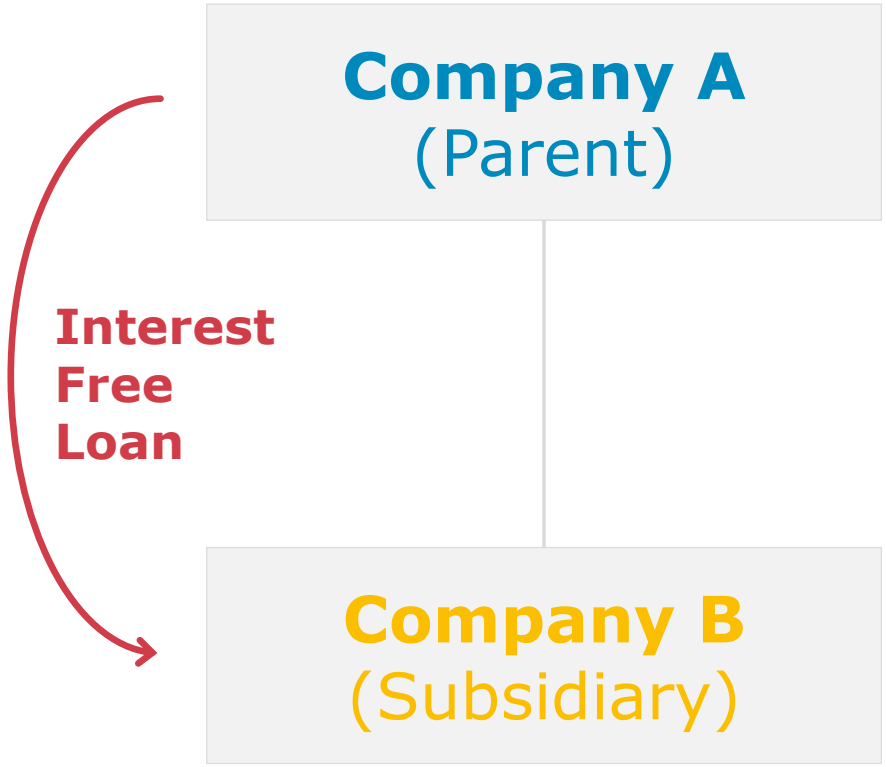
Outbound Interest: Tax Treatment of interest received in which non-residents receive interest payments from residents (e.g. payments made from a Cyprus Company)

INTERCOMPANY LOAN BY A SUBSIDIARY TO ITS NON-RESIDENT PARENT CORPORATION



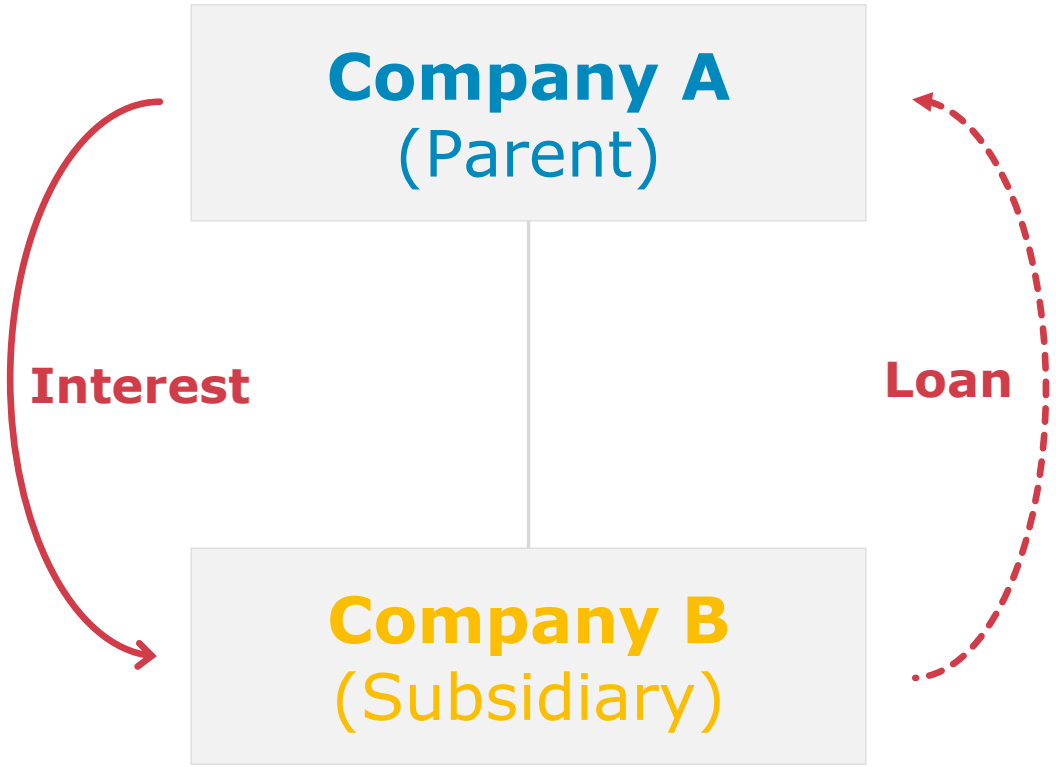
- **Company B**, subsidiary of **Company A** provides interest free loan.
- Might be characterised as distribution (dividend)
- Countries introduce anti-avoidance upstream loan rules

INTERCOMPANY LOAN BY A PARENT TO ITS SUBSIDIARY CORPORATION



- **Company A**, parent of **Company B** provides interest free loan.
- Might be characterised as equity (i.e. contribution to capital)

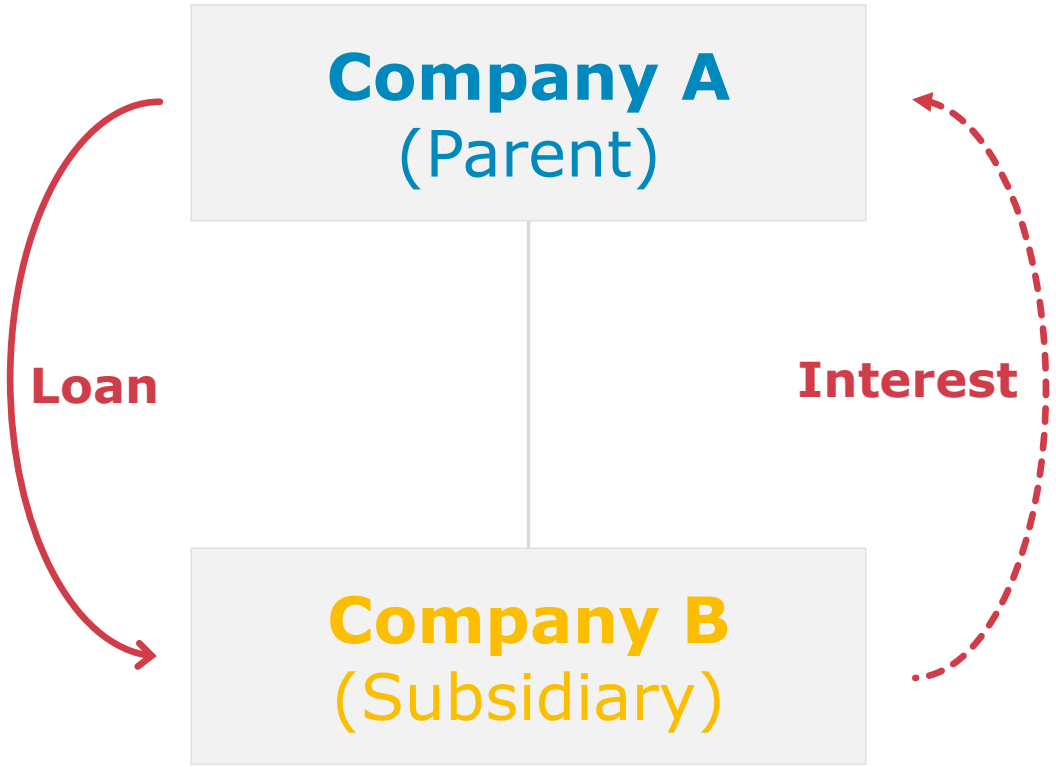
EXCESSIVE INTEREST: LOAN BY A SUBSIDIARY TO ITS NON-RESIDENT PARENT



- **Company B**, subsidiary of **Company A** provides a loan to its parent with interest rate in excess of an arm's length rate.

- The excess could be treated
  - contribution to the equity capital of the Subsidiary, or
  - interest-free loan by the Parent to the Subsidiary, or
  - partial repayment of the Subsidiary's loan to the Parent.
- Transfer Pricing adjustments:
  - Primary adjustment Country of the Parent (OECD Model Article 9(1))
  - Corresponding adjustment Country of the Subsidiary (OECD Model Article 9(2))

EXCESSIVE INTEREST: LOAN BY A PARENT TO ITS NON-RESIDENT SUBSIDIARY



- **Company A**, Parent of **Company B** provides a loan to its subsidiary with interest rate in excess of an arm's length rate.
- The excess could be treated as dividends
- Transfer Pricing adjustments:
  - **Primary adjustment** Country of the Subsidiary (OECD Model Article 9(1))
  - **Corresponding adjustment** Country of the Parent (OECD Model Article 9(2))

TRANSFER PRICING ASPECTS OF INTRA-GROUP LOANS

BROAD-BASED ANALYSIS

TP GUIDANCE FOR INTRA-GROUP LOANS (OECD TPG 2022)

Accurate delineation of the controlled transaction under Chapter I

- Alignment of the actual conduct of the parties (FAR analysis) and the contractual terms
- Characteristics of the financial instruments
- Economic circumstances (of the parties involved in the transaction and the market)
- Business strategies (purpose of the loan, MNE group's global financing strategy/policy)
- Options realistically available

Multi-factor analysis of the characteristics of the instrument and the issuer

- Quantitative methods (debt capacity analyses)

Consider domestic legislation

- Thin capitalization rules
- Limitation on interest deductibility measures
- Safe harbours

A TWO-SIDED PERSPECTIVE

Typical key functions performed by a **lender**

- decide whether and under which terms (including amount) to advance funds
- evaluate of the risks inherent under the loan
- asses the capability of the borrower to attract funds in light of the borrower's availability of own capital (financial capacity)
- supporting and documenting the loan
- ongoing monitoring and periodic review of the loan
- evaluate (investment) options realistically available

Typical key functions performed by a **borrower**

- ensuring the availability of funds to repay the principal and the interest on the loan in due time
- providing collateral
- monitoring and fulfilling any other obligations resulting from the loan
- evaluate (funding) options realistically available

FUNCTIONAL ANALYSIS

For intra-group loans it is important to ensure the functional analysis examines/includes

- Intra-group loan agreements
- Business plans for the borrower
- Forecast financial statements
- Financial modelling of loan servicing
- External loan agreements (of any group companies)
- Reports to external lenders
- Board papers
- Prospectuses issued by the group
- Interviews with the group treasurer, CFO, operational manager

May need to use specialist for the functional analysis

FUNCTIONAL PROFILES OF A TREASURY COMPANY – EXAMPLE PER TRANSACTION

	Agent	Risk-bearing	Strategic Treasury Company
Intra-Group Loans		X	
Cash Pooling			X
Hedging		X	
Financial Guarantees	X		
Other financial services	X		

PRICING INTRA-GROUP DEBT

APPROACHES TO PRICE INTERCOMPANY LOANS

The approach selected should be adequate both in *principle* as well as in *practice* in light of the information available

- Internal CUP
- External CUP
- Returns of realistic alternative transactions (economically cognate instruments; such as bonds, commercial papers, deposits, etc.)
- Cost of funds approach
- Economic modelling (build-up approach)
- Bank opinions – generally not appropriate for purposes of pricing intercompany loans

Sources:

Loans from external parties (must be comparable)

Commercial databases

Ask a bank to indicate the interest rate it would have charged?

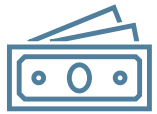
General external cost of finance for the group

DETERMINING INTEREST RATES

Consider applicable terms and conditions:

%

Interest rate is determined by: amount to reflect use of money (base rate – fixed or floating) amount to reflect risk (interest spread)



If there is no risk of default there is still a charge for the use of the money – often referred to as the base rate

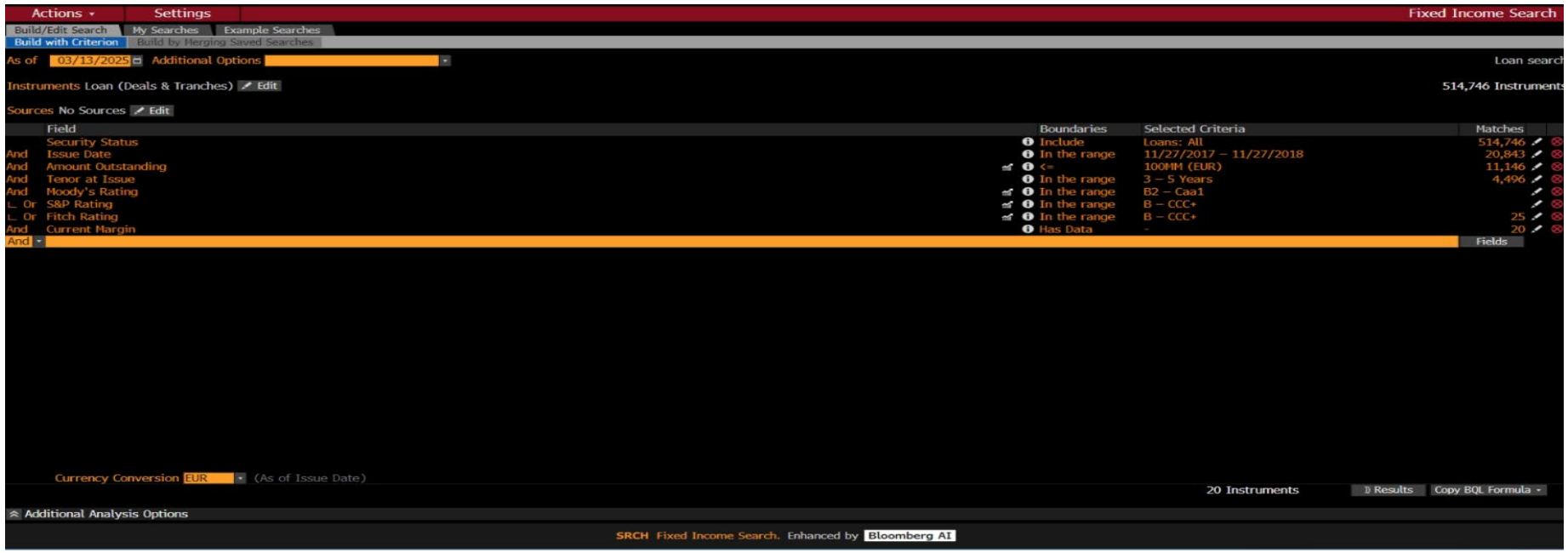
Lenders want to be competitive; they also want to make a profit; volume discounts and penalties may play a role.

Multifactor considerations beyond legal agreements:

- Credit worthiness of the borrower and of the instrument (not typically found in legal agreements)
- Macro economic conditions
- Specific business strategies

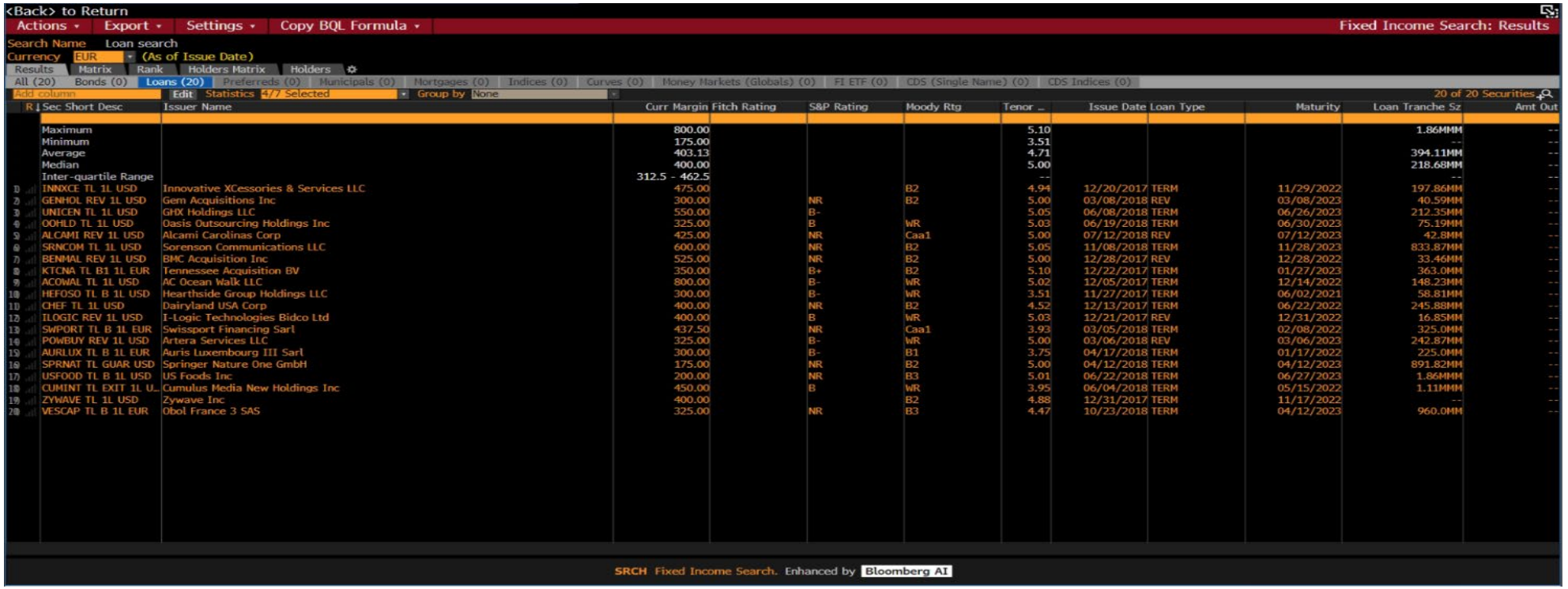
LOAN SEARCH CRITERIA – INTEREST SPREAD COMPONENT

Inputs table	Search criteria
Security status	Loans: All
Issue date	One year between 27/11/2017 – 27/11/2018, as a reasonable period prior to the start date of the Covered Transaction
Estimated c. rating	Approximate range including the credit rating at issue, of one notch above and below the rating of B-/ B3/ HY6.
Amount and currency	Approximate range including the amount and currency at issue
Maturity (in years)	Original maturity in the range of 3-5 years, as an appropriate range including the maturity at issue for the Covered Transactions
Interest Spread	To be evaluated



LOAN SEARCH RESULTS – INTEREST SPREAD COMPONENT

Range of search results - arm's length interest spreads	Minimum	Lower quartile	Median	Upper quartile	Maximum	Average
Loan	2.75%	3.00%	3.38%	4.50%	6.25%	3.77%



BASE RATE COMPONENT (SWPM EXAMPLE)

	Leg 1: Fixed	Leg 2: Floating	Comments
Amount (EUR)	10MM	10MM	The amount does not have an impact if the same on both legs
Currency	EUR	EUR	EUR as relevant currency
Effective date	21 December 2016	21 December 2016	Start date of the financing transactions
Maturity date	31 December 2024	31 December 2024	Maturity date of the financing transactions
Maturity (in years)	8Y	8Y	Maturity of the financing transactions
Payment frequency	Annual	Annual	Interest accrual schedule
Day count	Act / 365	Act / 365	Interest accrual period
Floating to-fixed swap rate	0.152780%	ESTRON	Fixed and floating base rates

COMMON COMPARABILITY ADJUSTMENTS FOR INTRA-GROUP DEBT PRICING

- **Credit rating adjustments**: reflecting differences in borrower or instrument risk
- **Currency adjustments**: accounting for risk where the tested loan and the comparable are in different currencies, especially if the borrower operates in a volatile currency environment. This may be especially relevant for bond searches
- **Collateral or subordination premium**: unsecured or subordinated loans generally require a higher spread than secured or senior-ranking instruments, usually this is factored in the credit rating analysis
- **Maturity adjustment**: longer tenors typically increase risk; spreads should be normalised when comparables differ materially in duration. If the range was broadened to get enough comparables, this adjustment may be required for precision
- **Liquidity premium**: public bonds are more liquid than private intra-group loans. A premium may be needed when using bond data to reflect illiquidity
- **Issue date adjustment**: aligns for changing market conditions. Comparables issued in different time frames may need adjustment for shifts in base rates or credit spreads

CREDIT RATINGS

FACTORS AFFECTING CREDIT WORTHINESS

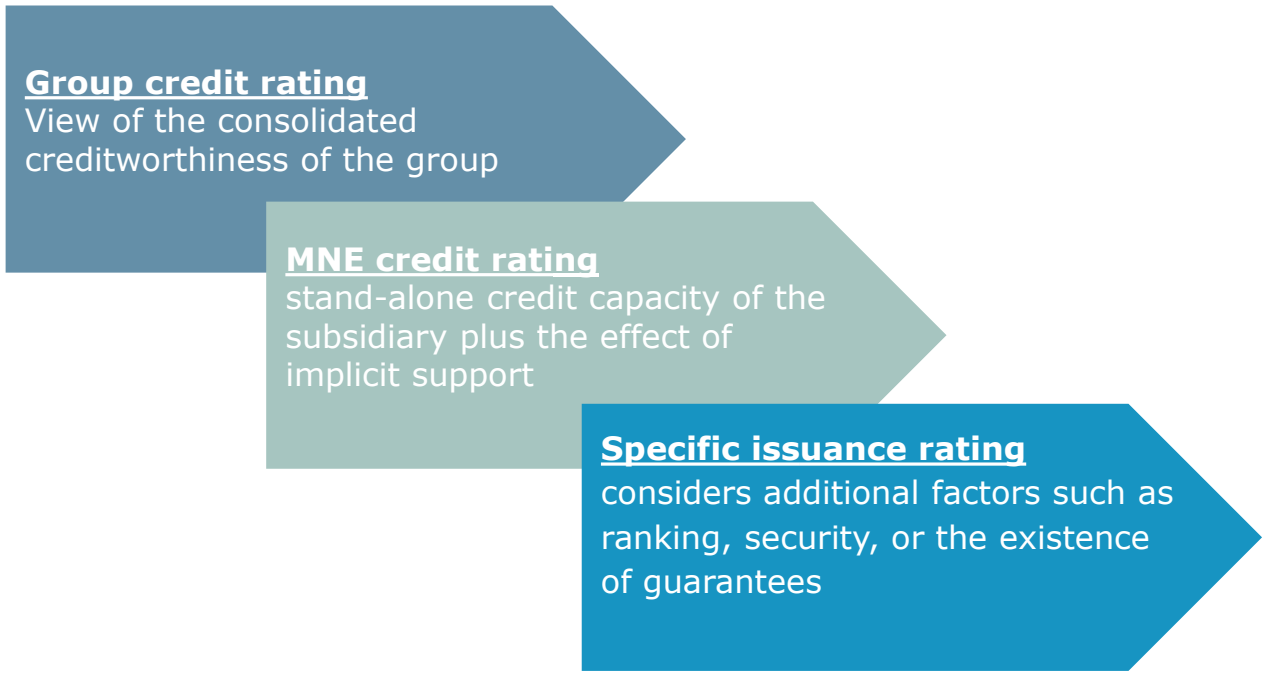
Key sources (consider timing issues):

- Bonds issued to the market with a known rating
- Stand-alone credit ratings as a starting point, based on the operational financials of the company
- Third-party loans are potential internal CUPs but also can be used for implied credit ratings
- Group ratings for listed companies (official) or derived from the operational consolidated financials
- Ratings from companies operating in the same geography and industry sector

Main Factors

- *Collateral (Assets pledged for the loan)/Security given*
- *Asset backing*
- *Level of other loans*
- *The ranking of the debt*
- *Gearing/leverage*
- *Interest cover*
- *Cash flow*
- *Covenants*
- *Guarantees*
- *Business risk*
- *Track record*
- *Purpose of the debt*
- *Industry prospects*

EVALUATION OF THE RISKS – CREDIT RATINGS



Credit rating analysis

- Understanding of the business
- Purpose of the loan
- Borrower's cash flow forecasts
- Strength of borrower's balance sheet

Points of attention:

- No specific guidance on the calculation of appropriate adjustments (e.g. ranking, security, implicit support etc.)
- The Guidance emphasizes the use of specific issuance rates where possible
- Explicit support in the form of intra-group guarantees is subject to a separate section in this presentation. Explicit support may also include pledges, mortgates or other securities.

STAND-ALONE CREDIT RATING (EXAMPLE BLOOMBERG DRSK) - INPUTS

	Borrower example
Total assets	24,153,614
Total liabilities	29,068,355
Current liabilities	11,301,702
Cash	819,782
Total equity	-4,914,741
Net income	-1,198,887
Revenue	996,123
Date of financials	2018
Currency	EUR
Bloomberg's Industry	Beverages
Country of risk	France
Rating result: (see credit rating analysis)	HY6

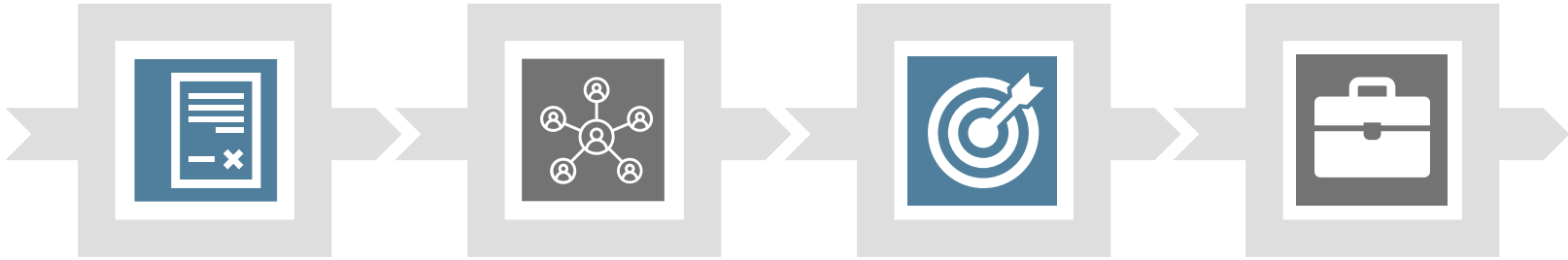
STAND-ALONE CREDIT RATING (EXAMPLE BLOOMBERG DRSK) - RESULT

CREDIT RATING SCALES

Rating grade description		Fitch	S&P	Moody's	Bloomberg	Estimated credit ratings
Investment grade	Minimal credit risk	AAA	AAA	Aaa	IG1	
	Very low credit risk	AA+	AA+	Aa1	IG2	
		AA	AA	Aa2	IG3	
		AA-	AA-	Aa3	IG4	
	Low credit risk	A+	A+	A1	IG5	
		A	A	A2	IG6	
		A-	A-	A3	IG7	
	Moderate credit risk	BBB+	BBB+	Baa1	IG8	
		BBB	BBB	Baa2	IG9	
		BBB-	BBB-	Baa3	IG10	
Speculative grade	Substantial credit risk	BB+	BB+	Ba1	HY1	
		BB	BB	Ba2	HY2	
		BB-	BB-	Ba3	HY3	
	High credit risk	B+	B+	B1	HY4	
		B	B	B2	HY5	
		B-	B-	B3	HY6	Example (2018)
	Very high credit risk	CCC+	CCC+	Caa1	DS1	
		CCC	CCC	Caa2	DS2	
		CCC-	CCC-	Caa3	DS3	
	In or near default, with possibility of recovery	CC	CC	Ca	DS4	
		C	C		DS5	
	In default, with little chance of recovery	DDD	SD	C		
		DD	D			
		D				

IMPLICIT SUPPORT AND THE RELATIVE STATUS OF A LOAN

Implicit support



Strength of linkage to the group
operational integration, legal obligations

Integration to the group's identity
shared name, reputational impacts

Importance to the groups future strategy
effects to the MNE group

Closeness to the group core business
strategic importance

IMPLICIT SUPPORT (1/2)

S&P Global Ratings, 'General Criteria: Group Rating Methodology', July 1, 2019, pp. 10, 41, 45-59.

Group Status	Brief Definition	Potential ICR
Core	Integral to the group's current identity and future strategy. The rest of the group is likely to support these entities under any foreseeable circumstances.	Group Credit Profile (i.e., GCP).
Highly strategic	Almost integral to the group's current identity and future strategy. The rest of the group is likely to support these group members under almost all foreseeable circumstances.	One notch lower than GCP, unless the Stand-Alone Credit Profile ("SACP") is equal or higher than the GCP, whereby the potential ICR is equal to the GCP.
Strategically important	Less integral to the group than 'highly strategic' group members. The rest of the group is likely to provide support in the most foreseeable circumstances. However, some factors raise double about the extent of the group support.	Three notches above SACP, subject to cap of one notch below GCP (unless the SACP is equal or higher than the GCP, whereby the potential ICR is equal to the GCP).
Moderately strategic	Not important enough to warrant support from the rest of the group in some foreseeable circumstances. Nevertheless, there is potential for some support from the group.	One notch above SACP, subject to cap of one notch below GCP (unless the SACP is equal or higher than the GCP, whereby the potential ICR is equal to the GCP).
Nonstrategic	No strategic importance to the group	SACP, subject to a cap defined by GCP.

IMPLICIT SUPPORT (2/2)

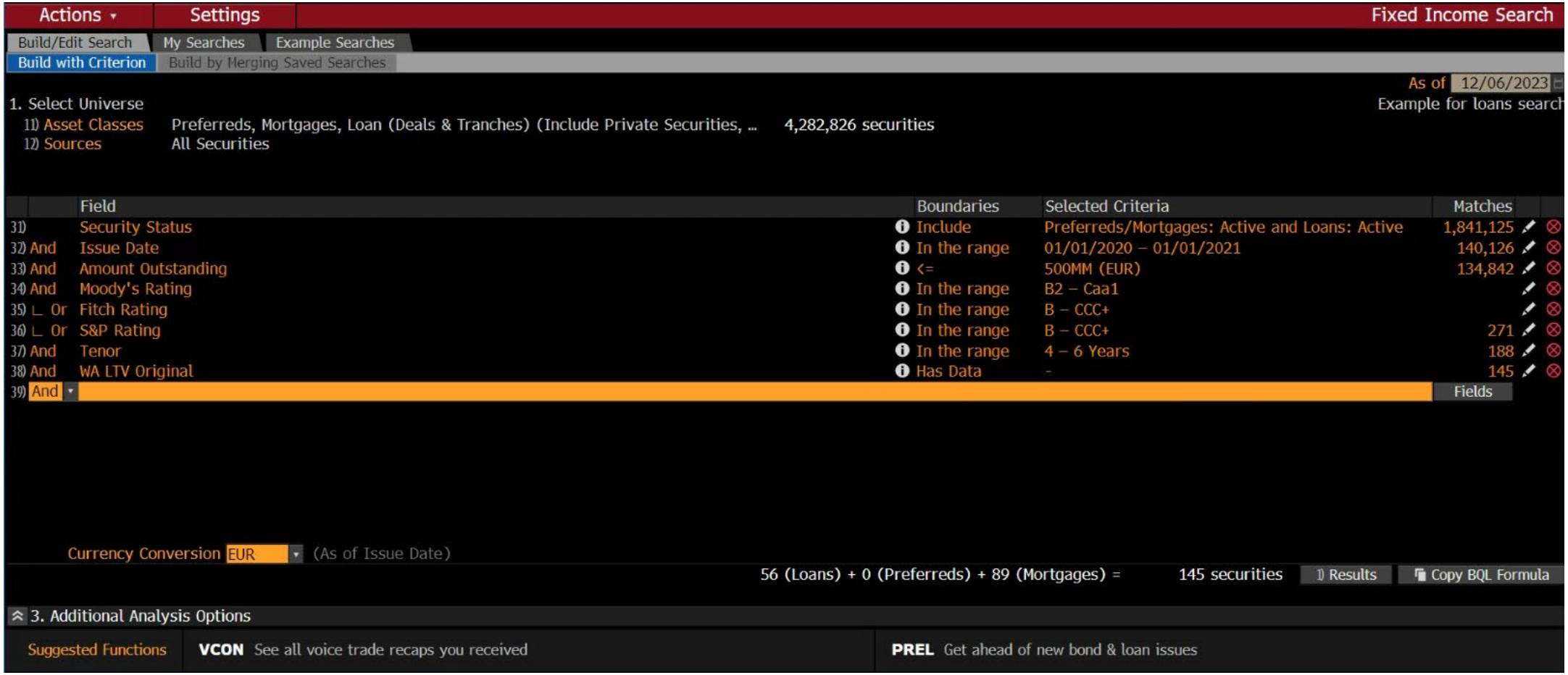
Characteristics	Core	Highly strategic	Strategically important	Moderately strategic	Nonstrategic
Company highly unlikely to be sold	Ö	Exhibits almost all characteristic of core entity	Ö		
Company is important to the group's long-term strategy	Ö		Ö	Ö	
Operates in lines of business or functions that are very closely aligned with the group's mainstream business and customer base.	Ö				
Has a strong, long-term commitment of support from the group in benign and under stressful conditions or incentives exist to induce such support	Ö		Ö		
Is reasonably successful at what it does or does not have ongoing performance problems that could results in underperformance against the group's specific targets and group earnings norms over the medium to long term	Ö		Ö	Ö	
Constitutes a significant portion of the consolidated group or is fully integrated with the group	Ö				
Is closely linked to the group's reputation, name, brand or risk management	Ö				
Has typically being operating for about five years or more	Ö				
Has been established as a separate entity for legal, regulatory or tax reasons, but otherwise operates more as a part of a profit center or division integral to the group	Ö				

DEBT CAPACITY

DEBT CAPACITY ANALYSIS: AMOUNT BORROWED

- **Can be tested by ratios** such as Debt to EBITDA and Debt to Equity
- The company's ratios would then be **compared to those of other companies** operating in the same sector and with the same economic circumstances
- **Economic modelling**: to determine what is the optimal amount of debt which maximises the return on the shareholder's equity, providing a reference for the debt-to-equity (from a financial standpoint not merely for accounting purposes).

LOAN- TO-VALUE (LTV) AND INTEREST COVERAGE RATIO (ICR) - SEARCH CRITERIA AND RESULTS



LOAN- TO-VALUE (LTV) AND INTEREST COVERAGE RATIO (ICR) - SEARCH CRITERIA AND RESULTS

Actions ▾ Export ▾ Settings ▾ Fixed Income Search: Results

Search Name Example for loans search

Currency EUR (As of Issue Date)

Results | Matrix | Rank | Holders Matrix | Holders

All (145) | Bonds (0) | Loans (56) | Preferreds (0) | Municipals (0) | Mortgages (89) | Indices (0) | Curves (0) | Money Markets (0)

Add column | Edit Columns | Group by None | 145 of 145 Securities

R	Asset Class	Issuer Name	Ticker	WA LTV Original	Fitch Rating	S&P Rating	Moody Rtg	Curr Margin	Tenor	Issue Date	Cpn	Maturity
	Maximum			91.000				1,000.00	6.00		15.456	
	Minimum			48.000				200.00	4.00		--	
	Average			65.292				459.21	5.01		5.655	
	Median			63.000				400.00	5.00		4.467	
	Inter-quartile Rar			59 - 70				--	--		--	
1)	Mortgages	Wells Fargo Commercial ...	WFCM	62.000			B3	--	--	03/13/2020	8.928	02/15/203
2)	Mortgages	CFK Trust 2020-MF2	CFK	69.000			B2	--	--	03/01/2020	3.573	03/15/203
3)	Mortgages	JP Morgan Chase Comme...	JPMCC	78.000			B2	--	--	02/19/2020	7.937	12/15/203
4)	Mortgages	Taurus 2020-1 NL DAC	TAURS	66.000	B-			--	--	03/12/2020	7.602	02/20/203
5)	Mortgages	BFLD Trust 2020-EYP	BFLD	62.000		B		--	--	10/07/2020	8.387	10/15/203
6)	Mortgages	Residential Mortgage Loa...	RMLT	70.000		B		--	--	01/01/2020	4.665	01/26/206
7)	Mortgages	Benchmark 2020-B18 Mo...	BMARK	63.000	B-	NR		--	--	07/01/2020	4.139	07/15/205
8)	Mortgages	CSMC 2020-FACT	CSMC	57.000			B2	--	--	10/28/2020	11.844	10/15/203
9)	Mortgages	GS Mortgage Securities C...	GSMS	77.000			B3	--	--	01/31/2020	8.694	12/15/203
10)	Mortgages	Canada Square Funding 2...	CSF	70.000		B+	B2	--	--	07/10/2020	8.670	12/17/205
11)	Mortgages	GS Mortgage-Backed Sec...	GSMBS	70.000	B			--	--	05/01/2020	3.423	10/25/205
12)	Mortgages	Cheshire 2020-1 PLC	CHESH	78.000		B	Caa3	--	--	08/13/2020	8.722	08/20/204
13)	Mortgages	Vermilion Bond Trust 202...	VERMI	63.000		B		--	--	10/14/2020	13.282	12/14/205
14)	Mortgages	Benchmark 2020-B16 Mo...	BMARK	57.000	B-		NR	--	--	02/01/2020	2.090	02/15/205
15)	Mortgages	Wells Fargo Commercial ...	WFCM	65.000	B-		NR	--	--	08/01/2020	4.157	08/15/205

Suggested Functions **VCON** See all voice trade recaps you received **PREL** Get ahead of new bond & loan issues

COMMON PITFALLS

KEY PITFALLS: TP ASPECTS OF INTRA-GROUP LOANS

- **Misalignment with accurate delineation principles**: Intra-group loans are sometimes priced without regard to the borrower's actual funding needs or business strategy. A common issue is assuming the form of the loan matches its substance, when in fact an independent party may not have entered into such a transaction on the same terms.
- **Inadequate or one-sided functional analysis**: Many TP reports emphasise only the borrower's financial capacity and ignore the lender's functions, such as credit risk assessment, decision-making, and monitoring. A two-sided functional analysis is critical, particularly when justifying the arm's length nature of the spread.
- **Flawed benchmarking approach**: Using bond yield data or banking rates without appropriate adjustments for comparability (e.g. tenor, industry, security, currency) undermines the reliability of the benchmark. Internal CUPs are often used without assessing whether they reflect market terms for similar risk profiles.
- **Overreliance on credit scoring tools without validation**: Models such as Moody's RiskCalc can be informative, but if used in isolation or without reconciling to observed market pricing, they may be rejected by tax authorities. The derived rating must be substantiated by independent evidence and aligned with the borrower's financials.
- **Use of safe harbour rates as a default benchmark**: Applying safe harbour interest rates without any further economic justification is a frequent mistake. While administratively convenient, such rates may not withstand audit scrutiny unless supported by a robust benchmarking analysis.
- **Lack of evidence for borrower debt capacity**: Some intercompany loans exceed what the borrower could realistically raise externally. This can result in reclassification of part of the loan as equity. Debt capacity modelling using ratios such as debt-to-EBITDA and interest coverage is essential to support the quantum.
- **Ignoring transaction-specific features**: Transfer pricing analyses often neglect terms such as subordination, payment rank, collateral, or group guarantees. These elements materially affect the risk, and hence pricing, of the loan, and must be factored into any benchmarking.

RECENT CASE LAW OF 2024

TP FINANCE: FRANCE VS GEII RIVOLI HOLDING, APRIL 2024 (1/2)

Issue: The French tax authority challenged the deductibility of interest payments (5.08%) on an intragroup loan, allowing only a lower safe harbor rate (2.79%).

Taxpayer's Defense: GEII Rivoli Holding justified its interest rate using two methods:

Moody's Analytics (RiskCalc) – Rejected

- RiskCalc is a credit scoring model that estimates a company's default risk using financial ratios.
- GEII Rivoli used it to determine a **Baa1 credit rating**, supporting its 5.08% interest rate.
- **Why rejected?** The court found the method unreliable in this context, possibly due to assumptions made in the model or its lack of direct market comparability.

S&P Bond Yield Curve Comparison – Initially Rejected, Later Accepted

- LTV used to determine GEII Rivoli's risk profile which was compared to BBB-rated companies and their corresponding bond yields.
- The taxpayer showed that at the loan date, 10-year market rates for BBB-rated firms were 5.21%, justifying the 5.08% interest rate.
- **Why initially rejected?** Lower courts argued that issuing bonds was not a realistic alternative for the company due to its size and market presence.
- **Why accepted?** The Conseil d'État ruled that bond market data can be a valid benchmark, provided adjustments are made for company-specific factors.

TP FINANCE: FRANCE VS GEII RIVOLI HOLDING, APRIL 2024 (2/2)

Outcome: The Conseil d'État overturned the lower courts' rulings, holding that using bond market data to determine an arm's length interest rate was valid.

Key Transfer Pricing Takeaways:

- **Use of bond market data upheld** – The ruling confirms that external bond yield curves can be a valid benchmark for determining an arm's length interest rate.
- **Rejection of the blanket "safe harbour" approach** – Authorities cannot automatically limit deductible interest to a statutory safe harbour rate without proper economic analysis

✓ **Challenges in proving realistic alternatives** – The court emphasized that companies must demonstrate that a bond issuance could be a viable alternative to an intragroup loan. [Potential comparability adjustments needed - Liquidity premium]

✓ **Importance of proper benchmarking** – Taxpayers should provide robust justification for their choice of comparables and make necessary adjustments.

Another French case: France vs Willink SAS, May 2024 – accepting Moody's RiskCalc to estimate ratings and S&P Capital IQ to seaarch for comparable independent loans, under certain conditions.

TP FINANCE: NETHERLANDS VS “REAL ESTATE LOAN B.V.” - MAY 2024 (1/3)

- "Real Estate Loan B.V." deducted **10% interest** on shareholder loans.
- Dutch Tax Authorities challenged the deduction, arguing the loans were "**non-businesslike**" and not at arm’s length.
- The **District Court upheld** the tax authority’s position.
- The company appealed to the **Court of Appeal**

TP FINANCE: NETHERLANDS VS "REAL ESTATE LOAN B.V." - MAY 2024 (2/3)

Judgment and key findings

- **Loan deemed "non-businesslike**" – No independent third party would have provided the loan under the same terms.
- **Deemed guarantee approach applied** – Interest rate should reflect a scenario where a third party grants a loan with a parent company guarantee.
- **Interest rate adjusted to 3.09%,** significantly lower than the claimed 10%.
- **Reclassified as dividend** – A large portion of the disallowed interest was deemed a shareholder distribution.

TP FINANCE: NETHERLANDS VS "REAL ESTATE LOAN B.V." - MAY 2024 (3/3)

Key Transfer Pricing Takeaways

- **Substance over form**: Shareholder loans must be structured like third-party loans to be deductible.
- **Market-based benchmarking is crucial**: Interest rates should align with what a third party would charge.
- **Guarantee analogy is a key approach**: When a loan is deemed non-businesslike, courts may use the parent guarantee rate to set arm's length terms.
- **Heightened scrutiny on intercompany financing**: Tax authorities closely examine related-party loans, emphasizing credit risk and realistic lending terms

TP FINANCE: UK VS KWIK-FIT, MAY 2024

- **Intra-group loan structure scrutinized** – The loan was part of a reorganization primarily aimed at securing tax benefits.
- **Interest rate set at LIBOR + 5%** – Not motivated by transfer pricing concerns but to **maximize tax savings** while remaining justifiable under TP rules.
- **Lack of commercial rationale** – Increased interest costs had no **non-tax justification**, as companies had the choice not to participate.
- **Differential treatment of loans** – Some intra-group loans had interest rate increases, while others did not—indicating a tax-driven motive.

Key Transfer Pricing Takeaways

- **TP defense requires a genuine commercial rationale** – Tax authorities scrutinize **interest rate setting** mechanisms in related-party loans.
- **Consistency matters** – Disparate treatment of similar intercompany loans may trigger scrutiny.
- **Substance over form** – Courts will look beyond documentation to assess the real economic purpose of financial transactions.

TP FINANCE: PERU VS "LENDER SA", APRIL 2024

Reclassification of equity as debt – Tax authorities treated the funds as loans, leading to the imputation of arm's length interest.

Application of the CUP method – The tax administration used banking sector interest rates to determine an arm's length rate.

Court ruled against tax authority's adjustment – Due to **insufficient comparability analysis**, the adjustment was overturned.

Key Transfer Pricing Takeaways

- **Proper comparability analysis is critical** – A broad selection of financial transactions without detailed matching on amount, terms, or borrower profile is inadequate.
- **Industry characteristics matter** – Comparables should reflect the **lender's business model** (not just banking institutions) and the **borrower's risk profile**.
- **Debt vs. equity classification remains a key TP risk** – Authorities can challenge classifications, but adjustments must be **properly substantiated.**

GROUP GUARANTEES IN INTERCOMPANY CONTEXTS:

TP CONSIDERATIONS

INTERCOMPANY FINANCIAL GUARANTEES

- Group guarantees are (financial) support arrangements **where one entity in a multinational group guarantees the (financial) obligations of another (group) entity.**
- Common in intercompany financing transactions, these arrangements **carry significant transfer pricing and tax implications.**
- Often seen in financial arrangement or specific industries
- Performance guarantees and financial guarantees
- Referenced in OECD TP Guidelines 2022, Chapter X and the OECD 2020 Guidance on Financial Transactions.

TYPE OF FINANCIAL GUARANTEES

- **Explicit guarantees**: Legal, contractual guarantees of debt obligations.

"a legally binding commitment on the part of the guarantor to assume a specified obligation of the guaranteed debtor if the debtor defaults on that obligation."

- **Implicit support**: Assumed benefit due to group affiliation, without a formal contract.
- **Credit support**: "letter of comfort" - legal rights to enforce the commitment.
- Tax authorities require proof of incremental benefit for explicit guarantees to justify a fee

TECHNICAL ANALYSIS: ACCURATE DELINEATION AND ARM'S LENGTH PRICING

- Evaluate economically relevant characteristics:
    - Contractual terms and functional analysis (nature and extent of the obligations guarantee)
    - Financial capacity and control over risks of the guarantor
    - Economic Benefit test: Would an independent party pay for such a guarantee?

"benefit arising to the borrower beyond the one that derives from passive association"

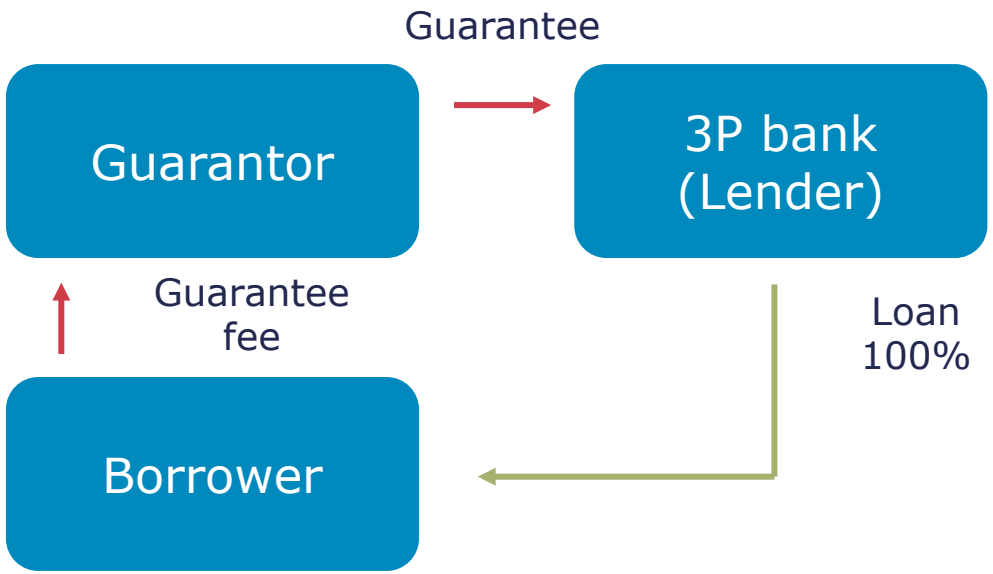
- Two (*no* - three) - sided approach:
    - **Borrower**: guarantee improves financial position
    - **Lender**: risk reduced
    - **Guarantor**: financial benefit beyond expected loss

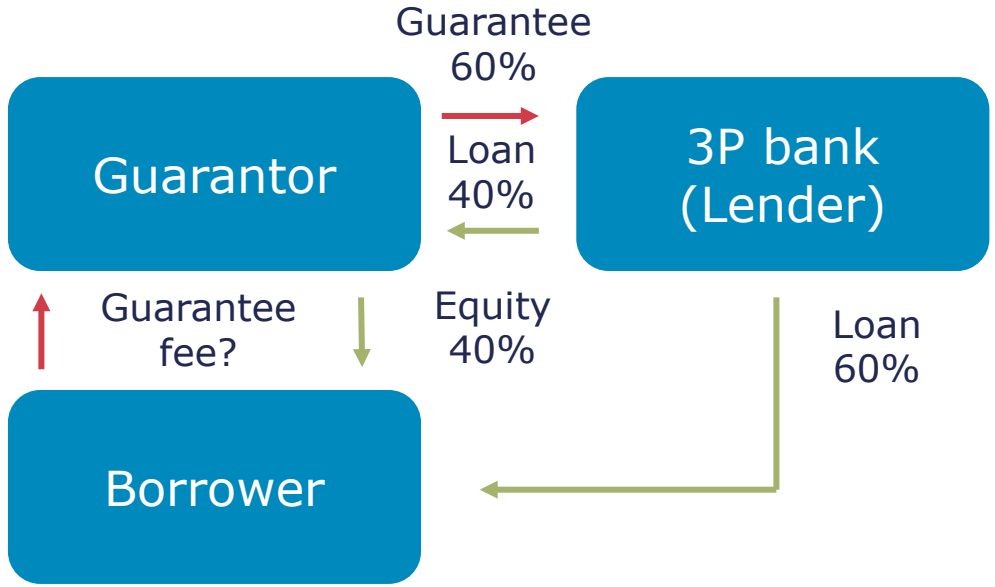
BENEFIT OF FINANCIAL GUARANTEES

- **Enhancement of terms** of the borrowing
  - Better conditions
  - Lower interest

- **Guarantors credit rating**: benefit can be achieved with even lower credit rating (wider recourse)

- Access to a larger amount of borrowings : loan? / Guarantee fee?





CROSS GUARANTEES

- **Where two or more entities in an MNE group guarantee each other's obligations.**
  - Lenders perspective: greater comfort, less risk
  - Borrowers perspective: guarantor for multiple borrowings
- Cash pooling
- Group wide funding facilities
- Complex
- Might not increase credit standing (beyond passive association)

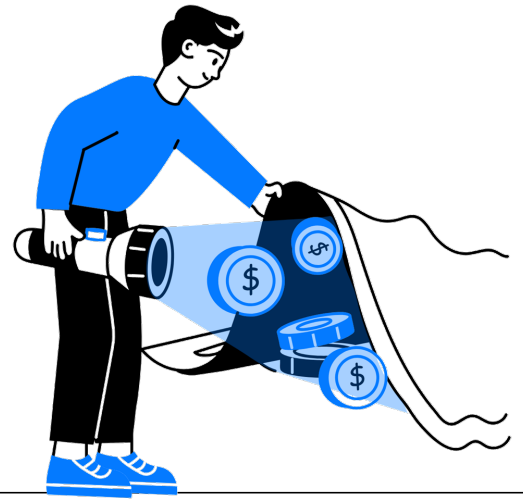
INTERCOMPANY PRICING: METHODS

- **CUP method**: external or internal comparables
  - Comparability analysis
  - Risk profile of the borrower, terms and conditions of the guarantee, term and conditions of the underlying loan (amount, currency, maturity, seniority etc.), credit rating differential between guarantor and guaranteed party, market conditions, etc.
  - Comparability often issue
- **Yield approach**
  - This approach quantifies the benefit that the guaranteed party receives from the guarantee in terms of lower interest rates.
  - Implicit support
  - Maximum guarantee fee
  - Bargaining power?

INTERCOMPANY PRICING: METHODS

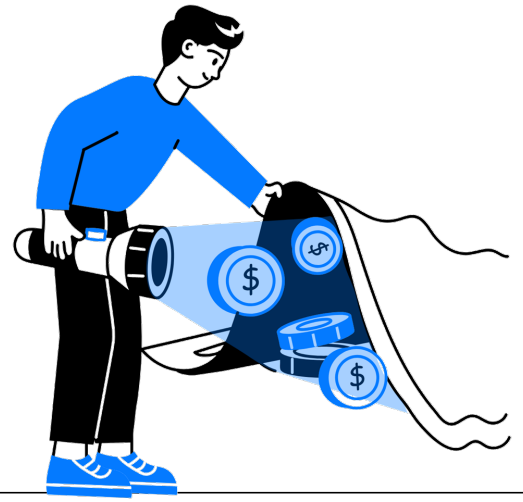
- **Cost approach**

  - Qualifies the cost the Guarantor expects increased with a risk / profit margin
  - Quantify the additional risk borne by the guarantor by estimating the value of the expected loss that the guarantor incurs by providing the guarantee (loss given default)
  - Estimating the expected loss and capital requirement (option pricing models, credit default swap pricing models)
  - Expected return on capital
  - Commercial pricing models such as the Capital Asset Pricing Model
  - Capital support method
  - Minimum guarantee fee



INTERCOMPANY PRICING: EXAMPLE

- Yield approach
  - Loan Interest Rate based on own credit rating (excl. support/guarantee): 9%
  - Loan Interest Rate based on own credit rating (incl. implicit support): 6%
  - Loan Interest Rate based on credit rating including explicit support guarantor: 4%
- Maximum guarantee fee 2% (6%-4%)



DOCUMENTATION / LEGAL REQUIREMENTS

- OECD requirements
- Some jurisdictions require strict documentation requirements (Germany, Australia)
- Aligning intercompany agreements with actual conduct

CASE STUDY

INTRA-GROUP LOAN FOR EXPANSION IN BRAZIL

Facts:

- Agroworld Holdings Ltd, a Dutch-headquartered multinational, manages group financing through Agroworld Treasury Ltd in Ireland. In January 2024, the treasury company granted a 7-year EUR 50 million fixed-rate loan to its Brazilian subsidiary, Agroworld Brasil Ltda, to fund the acquisition of farmland, irrigation systems, and equipment upgrades.

The loan characteristics are as follows:

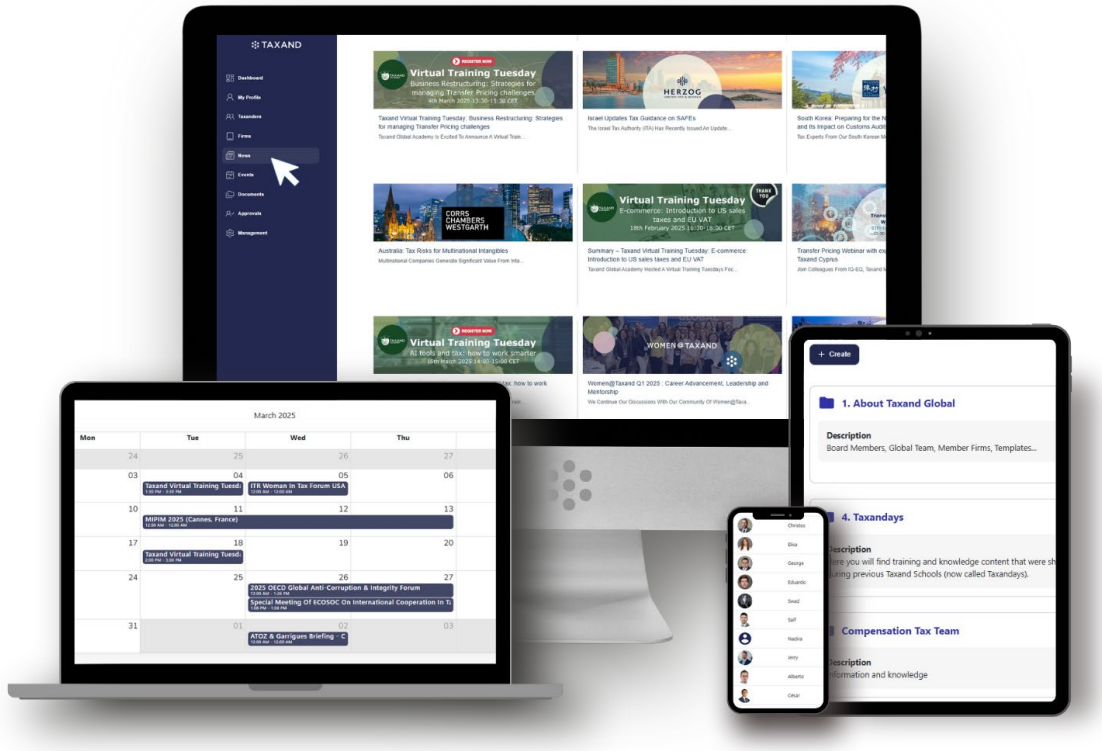
- ✓ **Interest rate**: 7.0% fixed p.a.
- ✓ **Currency**: EUR
- ✓ **Maturity**: 7 years, with no early repayment clause
- ✓ **Collateral and covenants**: None
- ✓ **Borrower's financials:**
  - No external debt
  - 3-year average EBITDA margin: 12%
  - Post-loan debt-to-EBITDA: 4.5x
- ✓ **Group policy**: Intragroup loans are used for operational expansion; no equity injection was considered
- ✓ **No internal CUPs** available; borrower operates in a volatile currency and inflationary environment

Discussion questions:

- How would you determine an appropriate credit rating for Agroworld Brasil for arm's length pricing purposes?
- How would you approach benchmarking the 7.0% interest rate, given the absence of internal CUPs and the Brazilian market environment?
- Does the 7-year maturity appear arm's length based on the borrower's profile and the purpose of the loan?

DISCUSSION
Q&A
KEY TAKEAWAYS

FIND OUT MORE ABOUT TAXAND GLOBAL!



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