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# AUSTRALIAN TRANSFER PRICING ALERT

More than 18 months after the publication of its non-consensus discussion draft on Financial Transactions (BEPS Actions 8 – 10) (the DD), the OECD released its [‘final’ guidance](#) on the transfer pricing of financial transactions on Tuesday 11 February 2020.

The original draft left some 25 areas of disagreement, representing a non-consensus position of the OECD’s Committee on Fiscal Affairs. Those areas largely appear to have been resolved.

The guidance is significant because it is the first time the OECD Transfer Pricing Guidelines will be updated to include guidance on the transfer pricing aspects of financial transactions, *‘which should contribute to consistency in the application of transfer pricing and help avoid transfer pricing disputes and double taxation’*.

The guidance addresses specific issues on the transfer pricing of treasury functions, intra-group loans, cash pooling, hedging, guarantees and captive insurance. It also provides clarity on the effect of group membership on debt capacity and loan pricing, such as the value (if any) of formal guarantees and implicit support. In addition, it addresses (albeit not wholly definitively) the issue, and implications, of the (stand-alone) credit ratings of individual subsidiaries of a multinational group.

One of the main contentious areas relates to the delineation and characterisation of financial transactions - notably the capital structure and treatment of intercompany balances that would present the characteristics of both debt and equity. The new guidance acknowledges that Article 9 of the OECD Model Tax Convention 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’*.



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It also elaborates on how the concepts of *'the accurate delineation of the actual transaction in the Guidance may relate to the balance of debt and equity funding of an entity within an MNE group'*. However, it is left to the domestic legislation of countries to *'address the balance of debt and equity funding of an entity and interest deductibility'*. As such, the issue has been somewhat sidestepped.

A specific point on lending may increase uncertainty for taxpayers. The guidance says that where a *'lender is not exercising control over the risks associated to an advance of funds'*, its return could be limited to a risk-free return. It would be the party actually controlling the risk, that would receive the risk premium and bear any downside risk (such as bad debt risk). While laudable in its aims, this could increase administrative burdens for businesses, especially as the guidance also recognises that the decision-making roles may be limited in practice across the group, and give rise to difficult accounting questions.

The guidance requires closer analysis and consideration, however, some immediate takeaways include:

- ▶ We finally have guidance from the OECD on how to price cross border financing transactions in line with the arm's length principle which is a positive step and long overdue
- ▶ Some flexibility on interpretation and implementation has been left to domestic tax and transfer pricing legislation (for example, [Australia's interpretation on the interaction of debt/equity rules](#))
- ▶ There is a need for companies to revisit and/or implement Group financing arrangements which take into account the new guidance as well as how this guidance sits with Australian specific requirements.

BDO will publish more detailed analysis, including interaction with Australian requirements shortly.

#### HOW CAN BDO ASSIST?

Our experts have in-depth experience in dealing with financing arrangements and can assist you to assess your position against the new guidance as well as Australian specific expectations. Please contact a member of BDO's transfer pricing team if you require assistance.

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