



OECD update: final guidance on the transfer pricing of financial transactions

On February 11, 2020, the OECD published its final guidance on the transfer pricing aspects of financial transactions. The final guidance is the result of the discussion draft that was published on July 3, 2018 and the input provided during the public consultation.

The new guidance will be included in the OECD Transfer Pricing Guidelines, mostly as the new chapter X. However, some of the guidance provided (mainly relating to guidance on risk-free and risk-adjusted rates of return) will be added to existing chapters of the 2017 OECD Transfer Pricing Guidelines. It is the first time that the OECD Transfer Pricing Guidelines will include guidance on how to deal with the transfer pricing aspects of financial transactions.

The new Chapter X of the OECD Transfer Pricing Guidelines will address the economically relevant characteristics that should be considered when analyzing the terms and conditions of financial transactions, including contractual terms, functional analysis, characteristics of financial products/ services, economic circumstances and business strategies.

For the determination of whether a purported intercompany loan should be regarded as a loan, the OECD maintained the position from the discussion draft and explicitly left the door open for countries to implement approaches in domestic legislation to address the balance of debt/equity funding of a company and the related interest deduction. Therefore, the risk of double taxation remains in this area.

Key general matters considered throughout Chapter X of the OECD Transfer Pricing Guidelines will include:

- » the importance of accurate delineation of the actual transaction in anticipation of setting the pricing;
- » a focus on two-sided analyses and consideration of options realistically available; and
- » the concept of implicit group support, to be taken into account in many cases.

The new guidance sheds light on specific transfer pricing issues, such as the treasury function, intra-group loans, cash pooling, hedging, financial guarantees and captive insurance. Chapter X will also provide more detailed guidance for determining and using credit ratings.

Guidance is also provided on the use of risk-free and risk-adjusted rates of return. This will be added to Chapter I of the OECD Transfer Pricing Guidelines. Additional guidance in this respect is especially useful for the remuneration of a company that lacks the capability, or does not perform the decision-making functions, to control the risk associated with investing in a financial asset. In that case, the company will be entitled to no more than a risk-free return for its activities.

A number of these issues had already been addressed in the Dutch transfer pricing decree of November 14, 2013 (No. IFZ2013/184M), which was ultimately updated and replaced by the Decree of April 22, 2018, no. 2018-6865 ("Dutch TP Decree"). The Dutch TP Decree includes guidance on financial transactions, such as guarantees, intra-group loans and captive insurance. However, it is not as comprehensive as the new guidance published by the OECD and only presents the Dutch tax authorities' perspective.

Key takeaways

The Netherlands has always been a frontrunner where the transfer pricing of financial transactions is concerned. With the publication of the Dutch TP Decree, the Dutch tax authorities provided some insight into how they regard intra-group loans, guarantees and captives. With the inclusion of Chapter X in the OECD Transfer Pricing Guidelines, the focus will be even more on the functions performed in respect of financial transactions and to whom the benefits of such transactions should be allocated. The pricing of financial transactions is also addressed in more detail.

In practice, we have seen many discussions with tax authorities about financial transactions and we expect the new guidance will lead to even more scrutiny. However, the new guidance also provides companies with more theoretical and practical guidance on how to establish arm's length transfer pricing policies for financial transactions. As before, robust transfer pricing documentation will be key to demonstrating the arm's length nature of financial transactions.

Information

Would you like to know more how these OECD developments can impact your business? Please feel free to contact Mark Bonekamp, Janneke Versantvoort or Neil Schaatsbergen from our team of experts. See our [website](#) for their contact details and for more information.

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