

Comments on the OECD Discussion Draft on Financial Transactions – Executive Summary

Working Party No. 6 – Tax Treaties, Transfer Pricing and Financial Transaction Division, OECD/CTPA

To

BonelliErede – VVA

From

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Reference

Date

Dear Sirs/Madams

BE–VVA¹ would like to thank you for the work done in drafting the BEPS Action 8–10 Discussion Draft on Financial Transactions (“**Draft**”) and are pleased to provide the executive summary of a preliminary set of comments and observations to contribute to the Draft’s implementation.

¹ BE–VVA is an exclusive alliance in the field of transfer pricing created by the law firm BonelliErede (“**BE**”) and the economic consultancy firm Valdani Vicari & Associati (“**VVA**”). BE–VVA combines a team of tax experts who hold prestigious positions at major universities teaching taxation and transfer pricing and a team of fully dedicated economists focused on economic consultancy in the fields of valuation, transfer pricing and commercial litigation.

Executive summary

One of the most significant techniques in the international tax arena for shifting profits relates to financial transactions. The OECD has devoted a great deal of effort to trying to resolve the underlying issues (among others, by issuing BEPS Actions 4 and 8–10) and to set out fundamental principles to reduce profit shifting.

The recurrent theme of the OECD’s efforts can be seen in BEPS Actions 8–10, which clarify that funding companies should merely be entitled to a risk-adjusted rate of return.

The OECD principles are very much in line with landmark court cases and tax legislation interventions by the European Union (e.g., ATAD 1 and 2).

In light of this, and considering the importance of ensuring continuity and harmonisation in interventions on the matter, we structured our comments to follow the topics set out by the OECD, with particular focus on: (i) interaction with the guidance in Chapter 1, Section D.1 of the OECD Transfer Pricing Guidelines; (ii) intra-group loans; and (iii) cash pooling.

Interaction with the guidance in Chapter 1, Section D.1 of the OECD Transfer Pricing Guidelines

With regard to Chapter B of the Draft, we first analyse the interaction between the recharacterization of a transaction and Arts. 9 and 25 of the OECD MTC and BEPS Action 4 (Box B.1). We raise our concern as to whether the Draft’s recommended approach (willing to lend/willing to borrow) suffices to resolve the problems relating to double taxation.

Subsequently, we examine the example of para. 17 (Box B.2) and provide some hints on its possible implementation and the practical implications that could arise regarding the concept of “maximum amounts”.

We then analyse the concepts outlined in paras. 17, 19 and 34 on financial projections and the ability to service the loan. We focus on: (i) the connection with Chapter VI of the TPG; (ii) the relevant flows to be considered (whether cash or income, net or operating); (iii) the purpose of financial projections; and (iv) the concerns deriving from the possible absence of financial projections.

We then welcome the provisions on the factors to be taken into account in analysing financial transactions (Box B.3) and suggest some additional factors that could

be included in the list. We also suggest to parameter the breadth of the analysis to the materiality of the transaction and the size of the multinational group.

Finally, we provide our view on the risk-free and risk-adjusted rate of return (Box B.4). With regard to the risk-free rate of return, we mention some key points relating to the financial instrument to be considered and the maturity of the risk-free investment. With regard to the risk-adjusted rate of return, we provide a non-exhaustive list of technical issues that could impact the calculation of the risk-adjusted rate of return.

Intra-group loans

With regard to Chapter C.1 of the Draft, we first focus on the concept introduced in para. 52 and raise our concerns regarding: (i) its compliance with the separate entity approach principle, and (ii) its possible practical implications in terms of burdening the taxpayer's effort and tax certainty.

Moreover, we provide our viewpoint on the group credit rating (Box C.2), focusing on the benefits of tax compliance and consistency with the separate entity approach.

Cash pooling

With regard to Chapter C.2 of the Draft (Box C.8), we first provide a practical example of a cash pool leader acting as an entrepreneur and examine its functional profile. We then focus on the approaches for allocating cash pooling benefits and provide examples based on our experience. Subsequently we provide a possible three-step analysis to determine the remuneration of the cash pool members (both when the cash pool leader acts as an entrepreneur and when it does not).

We then analyse the transfer pricing consequences of a member being obliged to participate in a cash pool (Box C.9).

Finally, we examine the treatment of surpluses in a cash pooling arrangement (para. 106) and suggest some practical approaches to address the topic.