TPA Global

TPA Global Treasury Playbook 2016

Transfer Pricing Solutions for Financial Transactions

4th Edition

What are the 2017 trends and topics for intercompany financial transactions?

1. Limited transfer pricing guidance from OECD and tax authorities on intra-group financial transactions
2. Local tax authorities limiting interest rate deductions on related party intra-group financial transactions through anti-avoidance legislation
3. Increased scrutiny of larger loans or other types of intercompany financial transactions (including overdraft accounts in a cash pooling arrangement or in-house bank structures), highly complex funding structures (including profit participation loans and other hybrid type loans) and funding structures using tax havens or non-treaty jurisdictions
4. Lack of understanding in estimating the credit risk of the related party borrower/obligor
5. Impact of “implicit” parental and/or group support and arm’s length debt capacity
6. Appropriateness of using corporate bond spreads in determining the arm’s length fee for intra-group financial (loan) guarantees
7. Considering a sustainable, arm’s length level of debt (capital structure) of the related party borrower, e.g. tax authorities are challenging the estimation of the related party borrower’s credit risk and therefore loan pricing

TPA Global provides international businesses with integrated and value-added solutions in improving financial performance, operational efficiency, strategic development and talent coaching through a cross-border and cross-discipline team of professionals which identifies the right solutions for customers and targets; efficient and streamlined advisory and implementation processes which cut through operational complexities across functions and borders; and superior customer service and support which proactively anticipate the evolving needs of the clients.

CUFTanalytics

CUFTanalytics specializes in providing transfer pricing solutions for all types of intercompany financial transactions. Our mission is to assist the global transfer pricing community of multinational taxpayers and tax administrations in mitigating transfer pricing controversy related to intercompany financial transactions.

Global collaboration and application

TPA Global and CUFTanalytics collaborate closely within the TPA Global network consisting of highly diverse group of specialists spanning over more than 65 countries around the world collaborating as one. Based on your global needs, our project team is formed by a unique mix of professionals with specialized expertise. Built on sound economic and financial principles, our methodologies have broad global application. We work with our affiliate offices to ensure local tax law and precedents are consistently followed.

Specialized expertise

We provide transfer pricing solutions with specialized expertise in intra-group financial transactions. Each of our professionals has at least 5 years of dedicated transfer pricing experience. Our 19 years of corporate banking experience brings a unique and very practical view to often complex transactions.

Investment in quality

We are determined to deliver high quality work. We have first hand knowledge of market benchmarking data through development of CUFTanalytics proprietary database of uncontrolled financial transactions. CUFTanalytics has made the upfront investment in research, market data, tools and methods and we leverage this investment into high quality, high value transfer pricing results for our clients.

Where we are?

250+ senior professionals

Transfer Pricing	50+ countries
Valuation	20+ countries
Customs	20+ countries

Americas

Argentina, Belize, Brazil, Canada, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, USA

Europe & Africa

Austria, Belgium, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Israel, Hungary, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Nigeria, Poland, Portugal, Romania, South Africa, Spain, Switzerland, Turkey, Russia, UK

Asia Pacific

Australia, Cambodia, China, Hong Kong, India, Indonesia, Japan, Laos, Myanmar, Singapore, Thailand, Vietnam

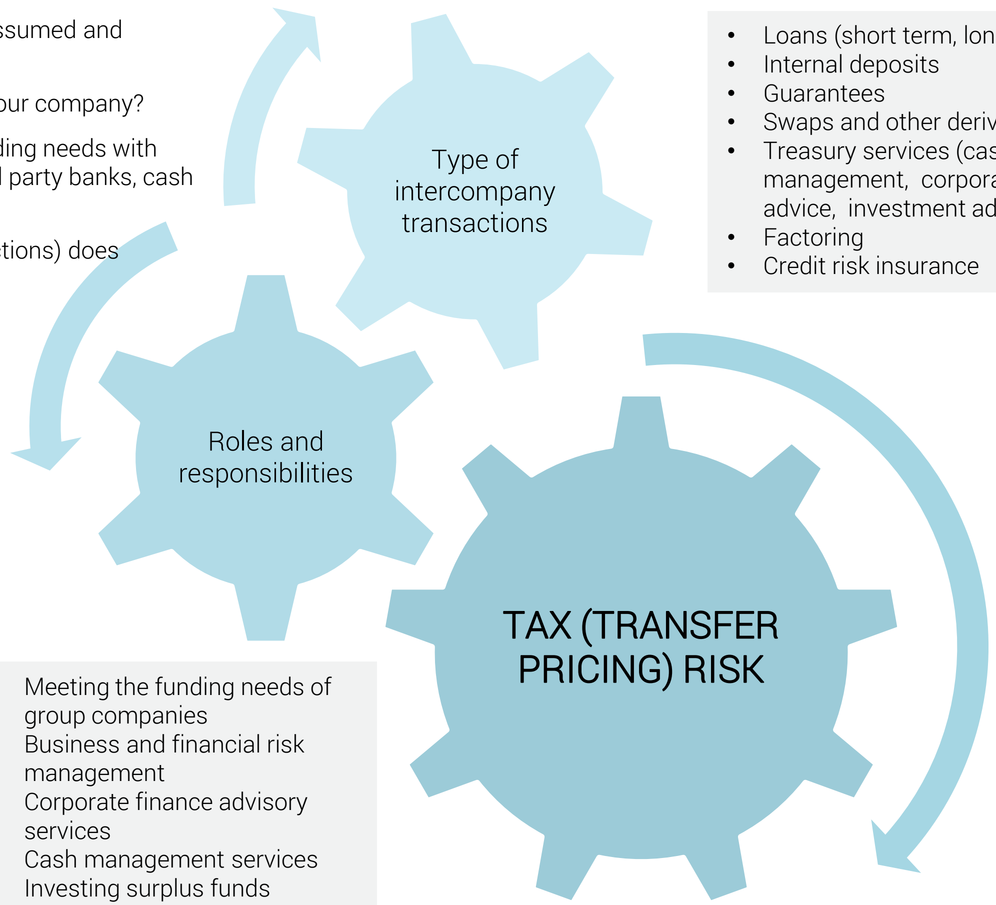
How can we help?

1. What is the lead role of a centralized treasury function?
2. What creates tax risk in your treasury operations and how do you manage this risk?
3. How can you design a group financing structure that is transfer pricing efficient?
4. How do you determine arms' length capital structures?
5. How do you determine credit risks?
6. What are the 'best organizational practices' for treasury operations?
7. Which transfer pricing method, economic analysis and data source to use?
8. Other topics: how to structure captive insurance operations (3 model approach)?
9. What hedging tools/techniques does treasury perform?

What is the lead role of a centralized treasury function?

Key issues

1. What are the functions performed, risks assumed and intangibles being employed by Treasury?
2. Is there a Global Treasury Policy within your company?
3. How does Treasury meet the group's funding needs with respect to direct loans, guarantees to third party banks, cash pooling arrangement?
4. What other services (non-financial transactions) does Treasury provide?



- Loans (short term, long term)
- Internal deposits
- Guarantees
- Swaps and other derivatives
- Treasury services (cash management, corporate finance advice, investment advice)
- Factoring
- Credit risk insurance

- Meeting the funding needs of group companies
- Business and financial risk management
- Corporate finance advisory services
- Cash management services
- Investing surplus funds

What creates tax risk in your treasury operations and how do you manage this risk?

Tax Risk in Your Treasury Operations

- Too little transfer pricing guidance from OECD
- Highly complex funding structures and/or use of tax havens or non-treaty jurisdictions
- Methodology selection that does not meet the arm's length standard and/or data that is not sufficiently comparable
- Insufficient documentation
- Assessment from local tax authorities can lead to potentially significant transfer pricing adjustments and related penalties

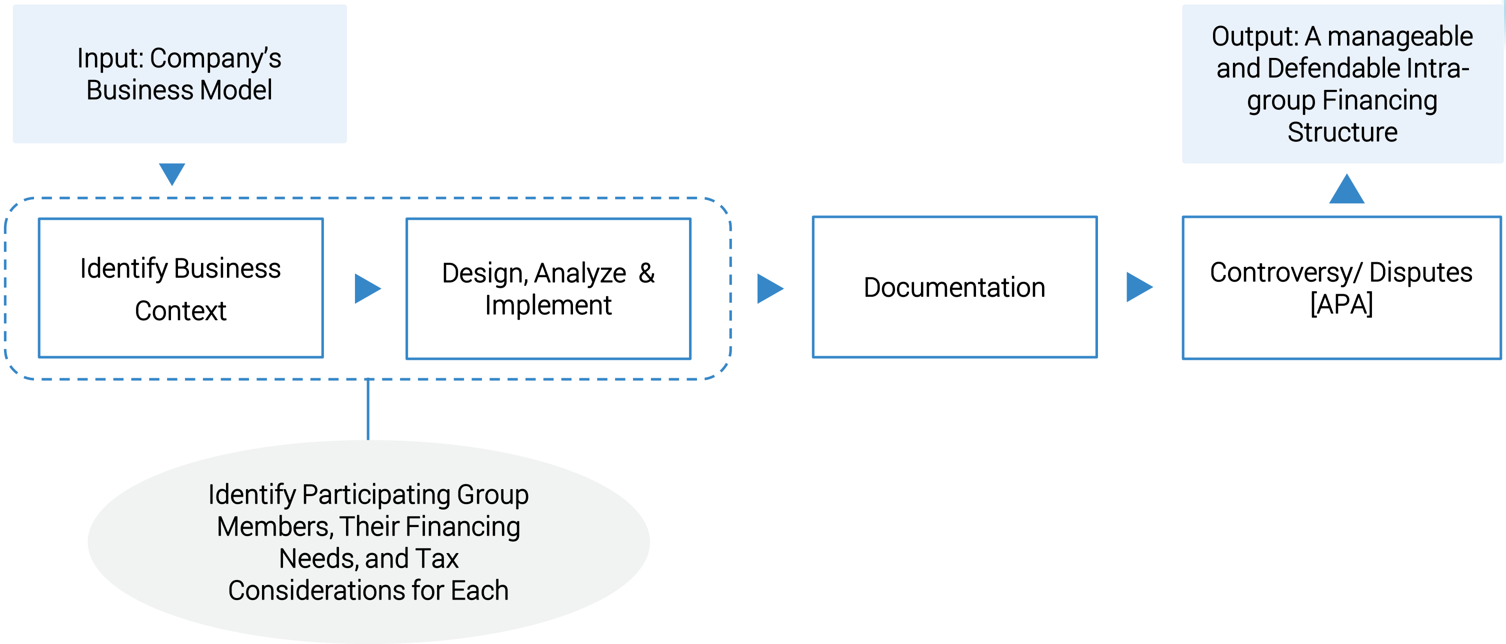
Impact on Treasury Operations

- What methodologies or processes must be implemented?
- Looking for better data sources for pricing treasury transactions
- How to improve operational and compliance efficiency

Impact on Treasury Costs

- Can treasury operating costs be lowered while mitigating future tax risk?

How can you design a group financing structure that is transfer pricing efficient?



Addressing the following key issues

1. How to identify the relevant business context?
2. How to design and implement an intra-group financing structure that meets group members' financing needs and overall business strategies, adheres to the arm's length principle and gives proper consideration to the tax legislation, rules and guidance from each of the countries involved?
3. How to determine the most appropriate transfer pricing methods for pricing various types of financial instruments and/or commitments?
4. How to document intra-group financing structures for transfer pricing purposes, and how to manage any related transfer pricing risk and/or controversy?

How do you determine Arm's Length capital structures?

	Financial Covenant Method	Financial Ratio Method
TP Method	Borrower Credit Risk (stand-alone or with implicit support)	Borrower Credit Risk (stand-alone or with implicit support)
Economic Analysis Benchmark focused on identifying →	Benchmark maximum leverage (or gearing) ratios from the financial covenants of comparable credit agreements	Benchmark the actual leverage (or gearing) ratios from the financial statements of sufficiently comparable companies
Database used	CUFTanalytics CUFT Database	Amadeus

Addressing the following key issues

1. Are debt levels greater than the subsidiary's arm's length level of debt or do they exceed the thin capitalization rules for the subsidiary's country of operation?
2. How can Treasury help to maximize the gearing ratio and maximize interest deductions?
3. How can Treasury determine the debt capacity of a group subsidiary?
4. Which top 3-5 leverage (or gearing) ratios should be used as part of the economic analysis?

How do you determine credit risks?

Factors to Consider

- Estimating the credit risk
- Use of third party credit risk estimation models (quantitative analysis)
    - What adjustments must be made?
    - What do the outputs mean?
    - How do the outputs compare to credit ratings?
- Qualitative factors that impact on credit risk
- Arm's length level of debt (capital structure) and impact on credit risk
- Consideration of "implicit" parental/group support on the estimated credit risk of the related party borrower

Key Variables

Determine key variables for each of the following:

- Senior loan pricing analyses
- Junior (sub debt) loan pricing analyses
- Guarantee fee analyses
- Factor rate analyses
- Derivatives spreads
- Other

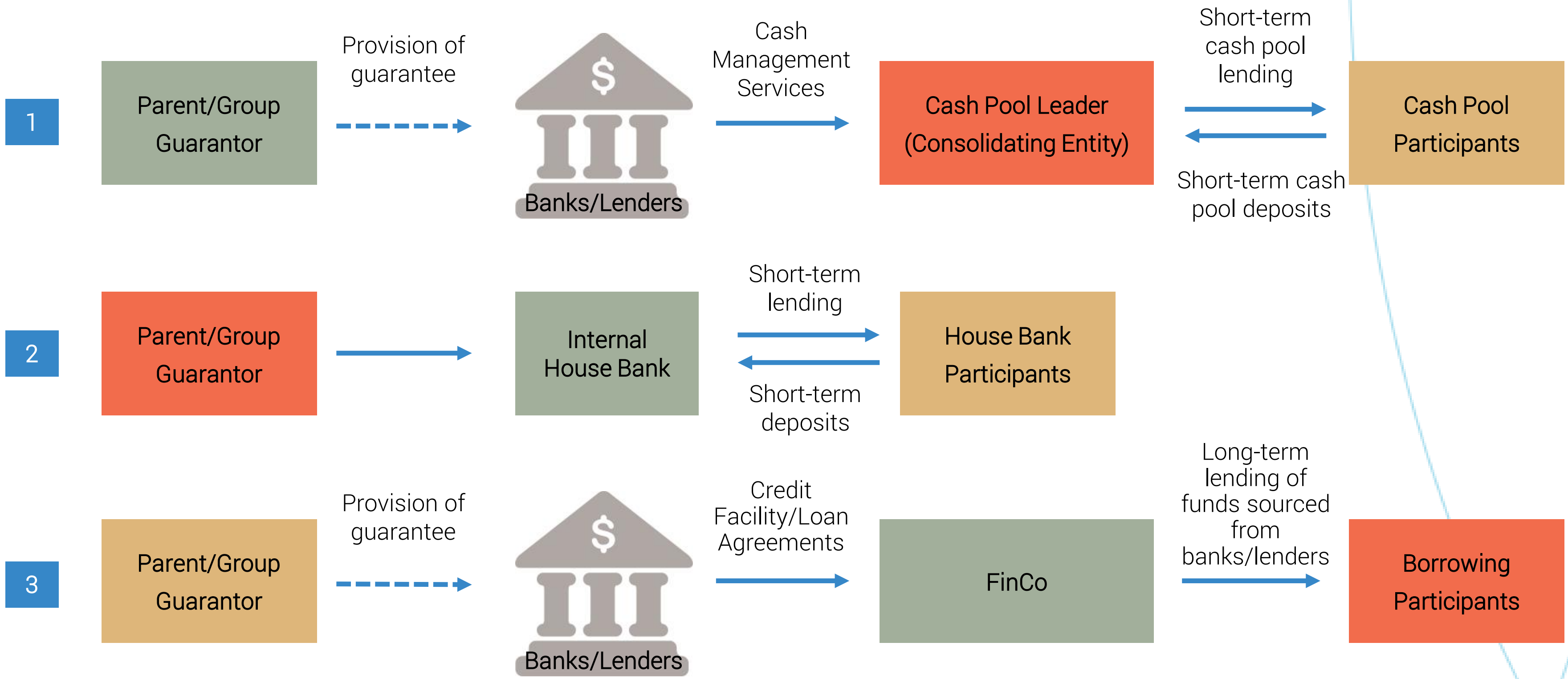
Perform "Credit Risk" Analysis

Synthetic or estimated credit rating of the related party/obligor in the intercompany financial transaction (stand-alone or with implicit parental support)

Addressing the following key issues

1. What credit risk estimation model(s) is Treasury using?
2. Is Treasury considering implicit parental support in estimating the credit risk?
3. Is Treasury considering arm's length debt capacity (capital structure) in determining the credit risk of related party?
4. How does Treasury price credit risk in a back-to-back (flow-through) financial transactions?

What are the ‘best organizational practices’ for treasury operations?

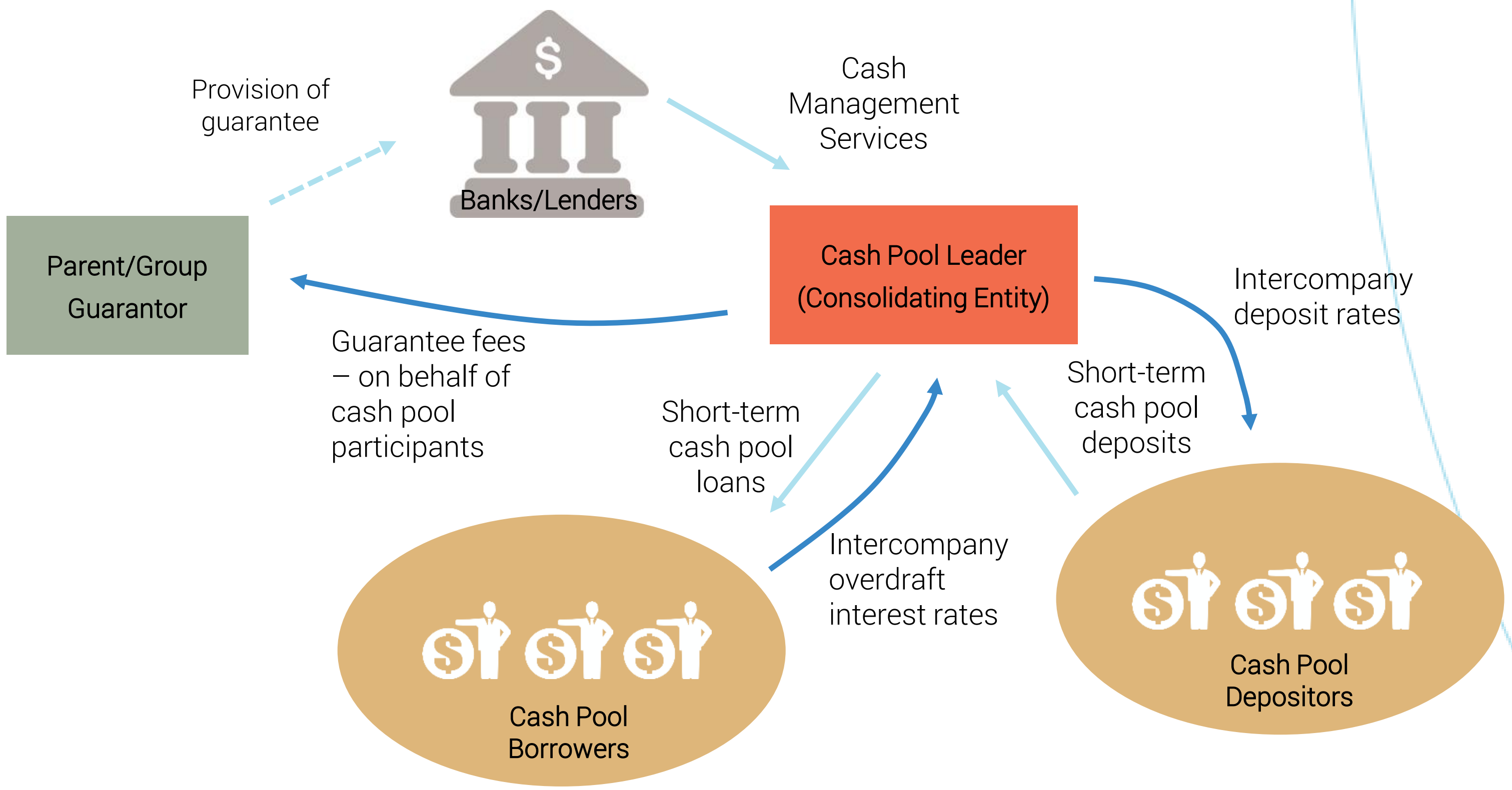


Addressing the following key issues

1. How to reduce external borrowing costs for group as a whole and increase investment income on surplus funds through cash management practices?
2. How to meet short-term/long-term funding requirements of group members?
3. How to effectively manage group member surplus funds (deposit accounts, money market investments)?
4. When to provide credit enhancement or financial support to group members via guarantees?

What are the ‘best organizational practices’ for treasury operations?

4



Which transfer pricing method, economic analysis and data source to use?

	Examples of Intercompany Financial Transactions			
	Senior Short term & Long term Loans	Junior Loans (Subordinated, 2nd Lien, etc.)	Loan Guarantees	Deposits
TP Method	CUP	CUP	Interest Rate Savings Approach	Return on Credit Risk Approach
Economic Analysis Benchmark focused on identifying →	Borrower Credit Risk (stand-alone or with implicit support)	Borrower Credit Risk (stand-alone or with implicit support)	Borrower Credit Risk (stand-alone or with implicit support)	Cash Pool Leader Credit Risk (stand-alone or with implicit support)
Economic Analysis Benchmark focused on identifying →	Arm's Length Lending Margins	Arm's Length Lending Margin	Split of the spread between actual and benchmark arm's length lending margin	Expected loss (EL) PD X LGD
Database used	CUFT Database and/or LoanConnector			S&P and/or Moody's default and LGD data

Addressing the following key issues

1. How to determine the credit risk of the tested party/borrower?
2. How to maximize gearing (financial leverage) within arm's length principle? Do thin capitalization rules apply?
3. What is the impact (if any) of implicit parental guarantee/support?
4. What period should be used as a threshold to distinguish between short term vs. long term loans?

Which transfer pricing method, economic analysis and data source to use?

	Other Types of Intercompany Financial Transactions		
	Preferred Equity	Receivables Factoring	Derivative Transactions (swaps, options, forwards)
TP Method	CUP	Other	Other
Economic Analysis Benchmark focused on identifying →	Credit Risk Arm's Length Dividend Rates	Credit Risk of trade debtors, default-free funding rate, and services charge	Credit Risk of counterparty(ies) to each leg of the transaction
Database used	CUFT Database	Moody's, S&P EL/LGD Data Solutions	Bloomberg swap rates, Moody's, S&P EL/LGD Data Solutions

Addressing the following key issues

1. What data is available to benchmark preferred stock dividend yields?
2. What comparability factors and adjustments need to be considered when performing an economic analysis for derivative transactions?
3. Which methodologies should be applied and what data should be used when the CUP methodology is not possible?
4. Which default free funding rate should be used when performing an economic analysis for receivables factoring?

Other topics: how to structure captive insurance operations (3 model approach)?

Through a Function/Risk/Equity Analysis

		First Model	Second Model	Third Model
Criteria	Diversification of risk	No	Yes	Yes
	Captive is making key decisions	No	No	Yes
	Captive possesses adequate capital to absorb insurance and insured risks	No	No	Yes
Outcome of the test	Responsibility of the Captive	N/A	Cost Centre	Profit Centre
	Typical transfer pricing model	N/A	Cost plus N/A (on Captive's operating expenses)	"CUP" or Premium calculation based on: 1. Risk adjusted return on capital 2. Loss predictions 3. Compensation for the Captive's operating expenses

Addressing the following key issues

1. How can I prove that my captive has a key decision role with respect to key policies relating to the insurance process?
2. Would a monthly conference call chaired from the captive premises and addressing key policies be enough to state that the captive has a key decision role?
3. How can I verify the 'arm's length' nature of our internal methodology used to calculate the premium to be paid by each insured affiliate to the captive?
4. How can I efficiently document the transfer pricing system of my captive having transactions with its 40 plus affiliated companies?

What hedging tools/techniques does treasury perform?

Hedging programs (foreign exchange, interest rates, commodities) are parts of the risk management function of Treasury

- Are these functions centralized?
- Do the subsidiaries do their own hedging and make use of the parent's Master ISDA?

Determine the costs/benefits of the hedging to the operating subsidiary (e.g. gains/losses on derivative contracts)

Selection of most appropriate transfer pricing method and comparable data (mainly credit risk data)

Addressing the following key issues

1. How are the hedging programs structured?
2. Which entity's risks are being mitigated by the hedging program?
3. Does Treasury act on behalf of (for the benefit of) the operating subsidiaries with respect to the hedging, i.e. providing a service or is Treasury acting as the intermediary in a derivative transaction with the subsidiary?
4. What transfer pricing documentation is in place for hedging services and intercompany derivative transactions?

Treasury & transfer pricing checklist: summary of key considerations

1. What functions does Treasury perform? What transactions are creating the most transfer pricing risk? Which group entities are exposed to the risk?
2. Does treasury have a group transfer pricing policy? Is it being consistently applied? Is it tax efficient?
3. Where is your greatest transfer pricing risk? Have those functions been sufficiently documented?
4. Which group entities are bearing credit risk and how should they be compensated for bearing credit risk?
5. How do you estimate credit risk? What credit risk estimation models do you use for assessing related party borrowers and obligors: quantitative credit risk estimation models? Do you consider qualitative factors in assessing creditworthiness?
6. How do you determine interest charges on loans, deposit rates, guarantee fees, and other charges?
7. Do you consider how unrelated parties price financial transactions? Are your transfer pricing methodologies consistent with the pricing methodologies applied by arm's length counterparties?
8. What market data do you use for benchmarking? Is this data considered reliable? Is it the most comparable data to determine the arm's length price for the tested financial transaction?
9. Do you perform a comparability analysis? Can you quantify and make adjustments for the identified major differences in comparability?
10. Do you use (have you considered) Advance Pricing Arrangements (APAs) to lower tax risk on financing structures or other complex intercompany financial transactions and financing structures?

TPA Global provides international businesses with integrated and value-added solutions in improving financial performance, operational efficiency, strategic development and talent coaching through a cross-border and cross-discipline team of professionals which identifies the right solutions for customers and targets; efficient and streamlined advisory and implementation processes which cut through operational complexities across functions and borders; and superior customer service and support which proactively anticipate the evolving needs of the clients.

H.J.E. Wenckebachweg 210 . 1096 AS Amsterdam . The Netherlands . +31 (0)20 462 3530 . tpa-global.com

tpa-global.com