

TransferPricing.Center Flash News

OECD Guidelines TRANSFER PRICING FOR FINANCIAL TRANSACTIONS

A new chapter of the **OECD Transfer Pricing Guideline** was opened recently! Are you **OECD compliant**?

On **February 11th, 2020**, the OECD has published **Transfer Pricing Guidelines for Financial Transactions**. The new guidelines will form a part of the OECD Transfer Pricing Guidelines published in 2017 as chapter X.

The new guidelines were driven by the BEPS project of the OECD and the connected action plan 4 concerning “Limited base erosion involving interest deduction and other financial payments” and action plan 8-10 “Aligning Transfer Pricing Outcomes with Value Creation”.

The highlights:

Mainly for the following transactions guidance was provide in the new transfer pricing publication of the OECD.

- Loans,
- cash pooling,
- hedging,
- financial guarantees and
- captive insurances.

Beside the guidance of an accurate delineation of the actual transaction, an approach was described, where an analysis of the **dept / equity ratio** of the affiliated party is the starting point for the pricing of selected transactions (e.g. loans and financial guarantees). In case the dept / equity ratio of the lender is not “**at arm’s length**”, some parts of the loan will be “reclassified” as equity and following the **interest** on this part of the capital will be not deductible.

Central for the transfer pricing, according to the guidelines, is the questions about the **risk**. Who bears effectively the risk, respectively which company is financially able to bear the risk and which company manages the risk?

In case a financing companies does not meet the requirement, it can be **reclassified** as service companies, for example. The remuneration of the transaction on the level of that financing company will than follow the principles for the remuneration of services, which can lead to a totally different

result compared to a remuneration assuming financial transactions. In other described cases the respective company is just entitled to earn a risk-free rate of return, if some preconditions are not met.

Furthermore, several transfer pricing methods are described in the report in connection with the pricing of the financial transactions. It is stressed in the report, that **internal comparable uncontrolled prices** should not be overlooked in the course of searching for the most appropriate method. Exotic method like the economic modelling for the pricing of a loan are named as a method in exceptional cases. Bank opinions are denied as evidence for arm's length condition. Approaches which are common in practice, including **the simulation of a rating** of the lender by using publicly available financial tools, followed by a **search for bonds** in databases with the respective rating, are also described in the guidelines. However, a lot of critical aspects are named in the guideline regarding the use of publicly available financial tools or methodologies, which could lead to a more critical view of the respective tax authorities on this approach to come to an arm's length transfer price.

As risk-free interest rates and the adjustment by a risk premium plays in a lot of cases a role in pricing financial transaction. The guideline outlines aspect in this regard at the end of the document. It is stressed that not only highly rated government issued securities are the only reference for a risk-free rate. As alternatives also interbank rates or interest swap rates can be considered for example.

It remains drilling how the tax authorities respectively the legislators in the different countries will consider the guidelines when they make their decision. The consideration of the countries is the precondition, that the aims of the OECD guidelines are met. International consistency in the transfer pricing treatment of financial transaction and following the avoidance of transfer pricing disputes and double taxation.

Please do not hesitate to contact [Michael Heckel](#) from [transferpricing.center](#) for further question regarding the financial transaction topic or any other transfer pricing issues you might be interested in.

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