Transfer Pricing Forum

Transfer Pricing for the International Practitioner

Financial Transactions (Loans)

While the OECD turns its attention to the treatment of financial transactions in its Transfer Pricing Guidelines, most countries already have had to deal with intra-group financial transactions, and many countries have been independently developing views about analytical rules and principles to deal with the increased importance many see this subject having in regard to their tax bases. This issue deals with the ways in which Forum countries currently address the issue of related party loans or related party guarantee situations. Even in the absence of OECD guidelines, tax examiners see these transactions, and in some way must deal with them. In this issue, we look at the "baseline" of countries' positions, before the OECD has spoken.

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to

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apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?
3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?
4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?
5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?
   a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?
   b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?
   c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?
   d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?
   e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?
   f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)? g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?
6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?
7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

THE TRANSFER PRICING FORUM is designed to present a comparative study of typical transfer pricing issues by Country Panelists who are distinguished transfer pricing practitioners in major and emerging industrial countries. Their discussions focus on practical questions posed by guidance, case law and practice in their respective jurisdiction, with practical recommendations whenever appropriate.

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Zachary Held
Duff & Phelps LLP, United States

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Argentina

Cristian E. Rosso Alba & Matías F. Lozano
Rosso Alba, Francia & Asociados

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

There are no specific methods for evaluating an arm's length interest rate on related party loans; rather, the general principles apply. According to Article 15 of the Argentinean Income Tax Law (ITL), transfer pricing methods can be divided into two groups: methods that substantially match the OECD Guidelines and purely local methodology. In the first group, are the Comparable Uncontrolled Price, Resale Price, Cost Plus, Profit Split and Transactional Net Margin Methods. In the second group, the core local feature is the so-called "sixth method" for pricing of commodities exports, a methodology that it is irrelevant for loans and financial transactions.

In selecting an appropriate methodology in a particular case, ITL does not provide for a set hierarchy in favor of the traditional transactional methods (i.e. Comparable Uncontrolled Price, Resale Price and Cost Plus) over the traditional profit methods (Profit Split and Transactional Net Margin). However, it does provide for the best method rule, which in many instances requires the so-called traditional transactional methods to be favored. In Argentina, while the five listed methods that match the OECD Guidelines are potentially suitable for evaluating taxpayers' transfer prices, only one will be regarded as the most appropriate one in each specific case, after reviewing the economic reality of the operation, as well as the assets, risks and functions involved.

When selecting the best method, one should consider the definition issued by the Argentine Revenue Service (ARS), through GR 1122/01, which says that the most appropriate method will be the one that:

- Best reconciles the commercial and business structure;
- Is presented with the best quality and quantity of available data supporting the proper justification and implementation;
- Has the most appropriate degree of comparability in the related and unrelated transactions, and in the companies involved in the comparison, and
- Requires the lowest level of adjustments to bridge any gaps between the tested situation and situations compared.

The selection of the best method in each specific case is part of the core expertise of the Argentine analyst. In practice, given the nature of financial transactions, the Comparable Uncontrolled Price - or Comparable Uncontrolled Transaction ("CUT")[1] - is usually considered the most appropriate method for intercompany loans in Argentina. Actually, it is the most widely applied by the Argentine Revenue Service ("ARS") during tax audits and assessments.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

In the absence of internal comparables at the tested party level, the CUP method first requires taking into account the characteristics of the borroweŕs market – namely, the location where the risk resides - to benchmark an interest rate. Under this point of view, for inbound transactions, domestic interest rates should be considered (e.g. domestic interest rates and standards published by the Argentine Central Bank, among others).

For a loan received by a legal entity located in Argentina, the interest rate to be used as comparable for transfer pricing purposes should consider the borroweŕs funding costs, thus focusing the search of comparable rates on the Argentine market.

Secondly, the analysis should focus on interest rates for loans to companies in the same currency in which they were granted (e.g. US dollars). Considering the information available at the Argentine financial market, a possible alternative for a relatively conventional analysis would consist on comparing the agreed rate between the Argentine entity and its related company abroad with the interest rates generally used for dollar-denominated loans.

The Argentine Central Bank ("BCRA") provides active interest rates in dollars under its norm on credit policy, "A" 6031, which covers the following transactions:

- Pre-financing and financing of exports;
- Other financing to exporters, with a future flow of foreign currency income;
- Financing to producers of goods to be exported;
- Financing to suppliers of goods or services that are part of the production process of exportable goods in foreign currency;
- Financing investment projects, working capital or the acquisition of all kind of goods, which increase or are linked to the production of goods for export;
- Financing to commercial clients that receive the treatment of credits for consumption or housing, whose destination is the importation of capital goods;
- Debt securities or certificates of participation in financial trusts;
- Inter-financial loan;
- Letters and notes of the BCRA in US dollars;
- Direct investments abroad by companies resident in the country;
- Financing of investment projects, including working capital, that allow the increase of production in the energy sector and have sales contracts or guarantees or total guarantees in foreign currency;
- Primary subscription of foreign currency debt instruments of the National Treasury, up to the amount equivalent to one third of the total of the applications made in accordance with the set provisions; and
- Financing of investment projects for cattle, including working capital, without exceeding 5% of the entity's foreign currency deposits.

Using the US dollar rates published by the BCRA for the activities described by the "A" credit policy 6031 is a valid starting point, in analyzing whether those rates could be considered comparable to the transaction under analysis (i.e. in view of the standards of ITL Article 21.2). Considering the specific characteristics of the rates mentioned above, if they are not comparable to the tested transaction, then a local interest rate denominated in AR$ (Argentine peso) is used, which should be later converted to the corresponding currency.

On the other hand, for outbound transactions foreign data sources - including interest rates at the borrowers market - are commonly used by ARS inspectors.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

A bona fide loan should respect the arḿs length standards and should be properly documented. Debt-to-equity recharacterizations of transactions between affiliated parties based on the non-arḿs length terms of a loan agreement have been commonly made by the ARS to challenge deductions of interest expense and foreign exchange losses by Argentine-affiliated debtors. In fact, concerning financial transactions between affiliates, the ARS[2] has indicated that debt to equity recharacterization should be made if:

1. There is no written agreement between the affiliates, which properly evidences the transaction dates, terms and conditions.

2. The terms are not in line with industry practice, or the parties have not properly performed the contractual obligations undertaken, for example, if the creditor has not enforced the agreement in cases of failure to make payments, or has not charged interest after maturity, etc.

3. The amounts lent are not commensurate to the debt to equity ratio of a debtor in arm's length conditions. According to the recently passed tax reform, interest expense from related party loans that exceeds 30% of the debtor's net taxable income, before deducting interest, amortization and taxes, may not be deducted.

4. Generally -while performing obligations over time- if the conduct of the related parties is only consistent with the one of a shareholder rather than a lender.

In all cases, interest expense that is to be deducted should be scrutinized under both norms: it should not exceed the thin-cap threshold and it should not exceed an arḿs length consideration for both the interest rate and any guarantee fee. If an affiliated borrower, located in Argentina, gets an interest-free loan from a related party from abroad, more likely the ARS will consider it equity, and will dismissed the foreign exchange deduction.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

Solely from the economic viewpoint, financial guarantees can be classified into two groups- explicit and implicit guarantees. In the first group (explicit) are guarantees that are formalized by an instrument and that generate rights and obligations for the parties involved. In the latter group (implicit) are the benefits associated with the fact that the debtor belongs to an international group whose name, brand and reputation contribute to reduce the financing costs (i.e. despite the lack of any specific support obligation that could be enforced). Of course, belonging to an international MNE group is something to which lenders are not indifferent, however, such "implicit" guarantees cannot be easily marked to market.

For this reason, and taking into account that there are no specific regulations that demand considering implicit guarantees, Argentine transfer pricing analysts do not tend to adjust the stand-alone creditworthiness of a borrower to reflect the possibility of parental or wider group financial support. Despite this, local practice tends to use "conservative" interest rates. In the case of a financial loan received by an Argentine taxpayer, transfer pricing analysts may employ commonly, as a benchmark, the lowest rates published by the Argentine Central Bank according to the kind of financial transaction under study, to the extent they are in fact comparable. This criterion has not been challenged by the ARS during the auditing procedures it has performed in the past.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

The credit rating of the entity receiving a loan could also be scrutinized as a variable in the arm's length interest rate analysis. In order to determine the credit rating of an entity, many econometric models are used in day to day practice to measure the financial health of a company through its financial statements, which allow diagnosis of the probability of a default.

On this regard, in day to day practice, financial models, like the Standard & Poor's Capital IQ Model or the EMS Z Score model, are usually applied.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Public data bases like the Argentine Central Bank's web page *www.bcra.gov.ar* or the Argentine National Bank, are commonly used for loan analysis. On the other hand, private data bases like Reuters or Bloomberg are also employed in day to day practice.

e. What, if any, safe-harbor rates, indicative, or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

There are no safe-harbor rates, indicative, or "suggested" margins for financial transactions provided by the Argentine tax authority.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

Considering that in the example given the loan was received by a legal entity located in Argentina, the interest rate to be used as comparable for transfer pricing purposes should consider such circumstances as a negative interest rate, thus focusing the search of comparable rates at the Argentine market. In fact, the borrower's market characteristics should be first taken into account, since it is the location where the risk resides.

In intercompany loans received by the Argentine entity the ARS considers local active interest rates as possible benchmarks; these are actually positive rates. On this regard, it should be noted that local interest rates are positive, even when converted to dollars or euros.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

As it was mentioned above, having written agreements properly drafted in view of local tax and case law standards is of the essence to avoid debt to equity recharacterizations, which are always very burdensome.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

No recent changes have been made to the Argentine transfer pricing framework in regard to financial transactions or hybrid arrangements.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Second paragraph of art. 14 of the ITL mentions that whenever a PE lacks a separate accounting or when such accounting fails to reflect the profits attributable to the PE, the ARS could consider the PE and its headquarters as one same economic unit, and determine the Argentine taxable income consequently, in view of the assets, risks and functions contributed by the PE.

On the other hand, if through separate accounting a distinct and separate enterprise can be reasonably determined then a separate entity evaluation of the PE should take place.

General transfer pricing regulations apply to the prices of transactions held by a local PE with their related parties abroad (e.g., headquarters), as well as to those transactions held between Argentine taxpayers and their PE located abroad. In those cases the arm's length standard should be observed evaluating the PE as a distinct and separate enterprise from its foreign headquarters.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

There is no specific country regulations covering financial transactions, therefore, the law does not expressly foresee compensation for guarantees. The applicable case law on the topic does not discuss whether it was mandatory to provide for one, nor the magnitude of the guarantee paid by a related party. Instead, the issue was whether the payment of a guarantee fee should be subject to withholdings at source.[3] The outcome was affirmative, as the guarantee fee paid by a local borrower to a non-resident affiliate was deemed to be Argentine source income, similar to the interest paid to the foreign lender.

From the transfer pricing viewpoint, local doctrine is in line with the idea that related parties should be charged for explicit guarantees, and if a local taxpayer is charged a fee for an implicit guarantee, the parties should have very carefully documented the way in which the implicit guarantee has helped in reducing the financing interest rate.

With regard to local regulations, it must be taken into account what was recently expressed by the National Tax Court when it mentioned that -even though Argentina is not part of the OECD- its Transfer Pricing Guidelines should be considered soft law, to complete the local regulations.[4] From this point of view it should be noted that the guidance of the Transfer Pricing Guidelines establishes that no fee should be charged where a parent has not actively sought to improve the credit rating of a subsidiary. However, these general standards should be scrutinized in each specific case, to test the benefit obtained by the affiliated party (who should pay a market consideration for it), the amount of the fee charged, and the local financial market conditions.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

As mentioned above, there are thin capitalization rules that should be observed in order to avoid debt to equity recharacterizations. Under these rules, interest expense from related party loans that exceeds 30% of a debtoŕs net taxable income before interest and amortizations may not be deducted. Recognizing that some groups are highly leveraged with third party debt for non-tax reasons, Argentine tax laws follow the BEPS-Action 4 approach, which proposes a group ratio rule alongside the fixed ratio rule. This would allow an entity with net interest expense above Argentinás fixed ratio to deduct interest up to the level of the net interest EBITDA ratio of its worldwide group. On this regard, Argentine Income Tax law provides that the 30% limit will not apply if it is evidenced that the ratio between the interest subject to such limitation and the net taxable income of the borrower is similar to, or lower than, a similar ratio that the economic group of companies bears with unrelated party lenders, for the same fiscal year.

Cristian E. Rosso Alba is a Partner in Charge of the tax practice at Rosso Alba, Francia & Asociados in Buenos Aires, Argentina. Matías F. Lozano works at Rosso Alba, Francia & Asociados in Buenos Aires, Argentina. They can be contacted at:

crossoalba@rafyalaw.com

m.lozano@rafyalaw.com

www.rafyalaw.com

NOTES

[1] Argentine regulations do not specifically distinguish between the CUP (Comparable Uncontrolled Price) and CUT (Comparable Uncontrolled Transaction) methods, but analysts identify the CUP as the method used to validate the sale of goods and the CUT as the method to validate the provision of services.

[2] Argentine Revenue Service ruling "INSTRUCCIÓN GENERAL N 747/2005 (DI PYNF)", dated November 21, 2005.

[3] Hidroeléctrica El Chocón SA - National Tax Court, Chamber C, 2007

[4] Case: Aventis Pharma S.A., National Tax Court, Chamber D, 2010.

Australia

George Condoleon
Duff & Phelps, Australia

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The Australian transfer pricing rules do not specify methods for determining arm's-length interest rates on international related party loans. However, Australian transfer pricing guidance refers to the requirement to add a margin to an appropriate base rate (for example, USD LIBOR or AUD Bank Bill Rate) to reflect the maturity of the loan, credit standing and other characteristics of the borrower and, to this end, recognizes that the CUP method is usually the preferred method for determining arm's-length interest rates.

In practice, the Australian Taxation Office (ATO) and taxpayers tend to apply the CUP method based on internal comparable transactions (if available) and/or external data sourced from third party databases such as LoanConnector/DealScan and Bloomberg Professional Service.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

No. However, in assessing the transfer pricing risk of intercompany loan transactions, the ATO is less concerned with the following features for outbound loans than for inbound loans:

- Security/collateral
- Subordination
- Exotic features (e.g. options)
- Leverage of borrower
- Interest coverage ratio

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

The current rules are unclear as to whether the transfer pricing rules can override the debt-equity rules in determining whether an instrument is considered debt or equity for Australian tax purposes. The Australian transfer pricing rules provide the ATO with wide powers to disregard the actual terms and conditions and reconstruct transactions undertaken by Australian taxpayers where:

- the legal 'form' of the transaction differs from the 'substance'; or
- independent entities would have entered into a transaction with different terms; or
- independent parties would not have entered into the transaction at all.

These reconstruction provisions are consistent with the 'exceptional circumstances' discussed in the 2010 OECD TP Guidelines in the context of the non-recognition and alternative characterization of certain arrangements or transactions.

The ATO is currently developing a Draft Tax Determination on the interaction between the transfer pricing rules and the debt-equity rules, which will provide the ATO's view on whether the debt-equity rules prevail over the transfer pricing rules. As at the time of writing, the Draft TD is expected to be released by March 31, 2018.

The ATO is also developing a Draft Tax Determination on outbound/inbound interest free loans, which will provide the ATO's view on whether interest free loans will be considered to be an equity contribution. This Draft TD is also slated for release on March 31, 2018.

The absence of a written loan agreement is not taken as determinative that the funds are a contribution to equity.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

The Australian transfer pricing regulations provide no guidance on how parent-subsidiary linkage should be taken into account in determining the credit rating of a borrower. The Federal Court in *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation*[1] concluded that the affiliation between the borrower and its group was relevant to the assessment of creditworthiness of the borrower; however, in the absence of a legally binding parental guarantee, implicit credit support has very little, if any, impact on pricing by a commercial lender.

Notwithstanding the above, it is the ATO's stated view that in most cases, the cost of financing for a borrower should align with the global cost of funds.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

The terms of any third party debt facilities can be used to derive a 'shadow' credit rating for the borrower. The credit profile of the debt instrument would also need to account for specific debt characteristics such as security and subordination.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

In the absence of internal CUP data, loan and bond transaction data sourced from Thomson Reuters LPC's LoanConnector/DealScan and Bloomberg Professional Service is typically used.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The ATO provides for a simplified transfer pricing record keeping option (STPRKO) for low-level inbound and outbound loans. Specifically, a taxpayer can elect to apply the STPRKO for AUD-denominated cross-border loans under the following circumstances:

- The combined cross-border loan balance for both amounts borrowed and loaned was AUD50 million or less at all times throughout the year;
- For inbound loans, the interest rate was no more than the Reserve Bank of Australia (RBA) indicator lending rate for 'small business; variable; residential-secured term';
- For any outbound loans, the interest rate was not less than the published rate (4.34% in the 2017 income year);
- The Australian accounting consolidated group has not made accounting losses for three consecutive years;
- The taxpayer did not have related-party dealings with entities in 'specified countries'; and
- The taxpayer did not undergo a restructure within the year.

Where a taxpayer relies on this option, the ATO has provided assurance that it will not review the records that relate to the dealings beyond conducting a check to confirm eligibility.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

AUD interbank interest rates have always been positive so negative interest rates in the context of AUD-denominated loans have not been an issue historically. In relation to foreign-denominated loans (e.g. EUR), the issue of negative interest rates is often addressed with a LIBOR / EURIBOR "zero floor" consistent with market practice.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

The transfer pricing regulations take priority over other provisions of the tax law with the exception of the thin capitalization rules (see question 7, below). This means that to the extent that an entity is liable to a different tax result under the transfer pricing rules relative to other provisions of the tax law, the transfer pricing rules must be applied in working out the entity's Australian tax liability. This means that the ATO can impute additional interest income or deny an interest deduction where the pricing on the loan is not arm's-length and where the additional income or reduced expense results in the entity having a greater amount of assessable income, a lesser amount of a tax loss, lower tax offsets, or additional withholding tax payable in relation to interest.

Refer also comments under question 7 below.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements)a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

On November 24, 2017, the Australian Government released exposure draft (ED) legislation on implementation of the OECD's hybrid mismatch rules developed by Action Item 2 of the OECD BEPS Action Plan.

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The rules will apply to payments between cross-border related parties exploiting differences between the tax treatment of instruments and entities across different countries and that give rise to:

- a deduction/non-inclusion outcome ("D/NI"); or
- double deduction outcome ("D/D").

If a mismatch arises, it is neutralized by:

- disallowing a deduction; or
- including an amount in assessable income.

For example, where an Australian company receives foreign equity distributions from a foreign company that is entitled to a foreign income tax deduction, the distribution will no longer be non-assessable non-exempt (NANE) income and the distribution will be included in the assessable income of the Australian company. This would bring the Australian transfer pricing rules into play in assessing an arm's-length interest/dividend rate on the financial instrument.

The rules will apply to payments made six months following the date of Royal Assent. There is no grandfathering of existing arrangements.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Generally speaking, Australia's PE attribution rules do not adopt a 'separate entity approach' to recognize notional loan transactions between different branch operations. Rather, profit attribution is based on allocation of actual interest income and expenses arising from dealings with third parties.

In the case of multinational banks, the ATO permits a separate entity approach by recognizing 'internal loans' (and in certain circumstances, 'internal derivatives') as a proxy for attributing actual income and expenses of a bank from third party funding transactions where it is not possible to trace the external source and end use of the borrowed funds.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

A guarantee fee is recognized as a tax deduction when it is paid.

Generally, a separate guarantee fee is paid to the foreign affiliate – cross-border interest is subject to withholding tax whereas guarantee fees aren't.

The Australian transfer pricing rules provide no guidance on how an arm's-length guarantee fee should be determined. In practice, a guarantee fee is estimated by reference to the interest rate spread approach, credit default swaps, economic capital framework, or in some cases, option pricing models.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Thin capitalization rules limit the amount of debt deductions (broadly interest and other borrowing costs) available to both foreign controlled entities and Australian entities with overseas operations, with debt deductions exceeding $2 million. The rules apply when the entity's debt-to-equity ratio exceeds certain limits: a safe harbor test (1.5:1 debt-to-equity for general entities, 15:1 for non-bank financial entities and 6 per cent of risk weighted assets for ADIs), world-wide gearing test and an arm's-length debt test.

Where taxpayers rely on the "safe harbor" under the thin capitalization rules, the Australian transfer pricing rules require the rate on a debt interest to be worked out having regard to an arm's-length amount of debt. However, this rate is applied to the actual amount of debt up to the safe harbor limit instead of the arm's-length debt amount to work out the debt deductions for the income year.

Refer to comments under question 3, above, in relation to the interaction between the Australian transfer pricing rules and debt-equity rules.

George Condoleon is the Director of Transfer Pricing at Duff & Phelps in the Sydney, Australia office.

He can be contacted at:

George.Condoleon@duffandphelps.com

www.duffandphelps.com

NOTES

[1] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* (No 4) [2015] FCA 1092.

Austria

Alexandra Dolezel and Maria Vasileva
PwC, Austria

1. Does your country specify permissible methods for evaluating an arm's- length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The Austrian Transfer Pricing Guidelines published in 2010 ("VPR 2010") generally follow the OECD Transfer Pricing Guidelines and the Austrian tax authorities are obliged to follow the rules contained therein, even though they do not have a legally binding character on taxpayers.

The VPR 2010 express a clear preference for applying the CUP method to determine the appropriate interest rate for intercompany financing. This is in line with the OECD Transfer Pricing Guidelines, which describe this method as the most direct way to determine whether the terms agreed between related parties are comparable to the terms and prices charged between independent companies in comparable circumstances.

Thus, the CUP method is considered to be the most appropriate method to benchmark interest rates charged in intragroup financing transactions. However, the VPR 2010 does not currently contain in-depth guidance on how to apply the CUP method to testing intragroup interest rates. The VPR 2010 instead describe the generally accepted approach on applying the CUP method. In practice, it is often referenced to fair market yields on corporate bonds of comparable borrowers (external CUP).

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

No, the Austrian transfer pricing guidelines do not express differing valuation methods for inbound and outbound finance transactions.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's- length basis. How are these issues dealt with in your country?

In practice, intragroup financing transactions are most often tested using the internal or external CUP method (using databases such as Bloomberg and LoanConnector), because external funding provided to the borrower from a bank would most likely not be comparable in its purpose, terms and conditions to the intragroup funding provided to the borrower by its parent or other group companies. The Austrian tax authorities use the Bloomberg database in their practice and express a general preference for it.

The VPR 2010 stipulate that the following factors (among others) must to be taken into account when analyzing the arm's- length character of an intragroup loan: the credit rating of the borrower; the date of issue of the loan; and the loan's maturity, currency and loan amount, with the credit rating generally deemed to be the most important consideration.

No guidance is provided in the VPR 2010 with regard to the establishment of the credit rating of the borrower, when no formal credit rating has been estimated by an external credit rating agency (Fitch, Moody's, S&P). However, it is expected that the determination of an indicative credit rating follows market logic (e.g., taking into account the rating of the country of the borrower and that of its parent's credit rating).

Though there are no clear rules in this regard, a further consideration when determining whether an intragroup loan has been granted at arm's length could also be the implicit support enjoyed by the borrowing entity.

In any case, the analysis of the arm's- length nature of the interest rate in an intragroup loan setting should be supported by a robust transfer pricing analysis and an analysis of the functions and risks undertaken by both entities. This holds true especially in light of the Austrian Transfer Pricing Documentation Act (VPDG 2010), whereby the affected companies that fall within the scope of its regulations must document all of their material intercompany transactions and support them with the appropriate economic analysis.

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4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

As of the time, Austria has neither announced nor adopted any new related rules regarding Hybrid Transactions. Further, Austria has filed for an extension of the implementation requirements of any such rules up to January 1, 2014, based on the reasoning that Austria already has comparable rules in place. According to our knowledge, the EU Commission has not yet officially confirmed that Austria has rules in place that are equally effective as the rule on interest limitation.

Currently, Austrian tax law disallows the tax deduction of interest payments to affiliated companies in low-tax countries (under 10% corporate tax) and on intragroup acquisitions of participations in legal entities.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Austria is following the OECD Report on the Attribution of Profits to PEs ("the PE Report") with respect to the rule stating that PEs would typically be expected to have the same creditworthiness as the enterprise as a whole, enabling them to borrow and on-lend at a profit on the same terms, except in unusual situations (item 99, Part I, Section D-2 (v)).

Under item 100 of the PE Report, an exception might be made when for regulatory reasons the capital attributed to the PE of one jurisdiction is not available to meet liabilities incurred elsewhere in the enterprise. Further, item 30 of the PE Report highlights another exception: when assets located in a specific jurisdiction are not available to meet claims outside the jurisdiction or have been earmarked to support a particular financial instrument in order to give that instrument the desired rating by a credit rating agency.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Intercompany guarantees should generally be remunerated on an arm's- length basis. However, if the guarantee is required to establish the creditworthiness of the borrower because it is poorly capitalized; or not yet in a position to raise debt externally because it lack's a sufficient business history (i.e., it is in start-up phase), no guarantee fee is admissible under general Austrian CIT law and the related jurisdiction of the Austrian Administrative High Courts.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

There are no explicit tax regulations available under Austrian tax law stipulating the minimum equity required by a company ("thin capitalization rules"). Basically, group financing has to comply with general arm's--length requirements. Therefore, an Austrian group entity being financed by an affiliated entity must be able to document that it would have been able to obtain funds from third-party creditors under the same conditions as from an affiliated financing entity. Therefore, the appropriate ratio between an Austrian company's equity and debt will depend mainly on the individual situation of the company (profit expectations, market conditions, etc.) and its industry.

If an intercompany loan is not accepted as debt for tax purposes, it is reclassified as hidden equity, and the related interest payments are recharacterized as (non-deductible) dividend distributions. To avoid reclassification of the intragroup loan as hidden equity, documentation of the arm's- length nature of the loan will be requested by the tax authorities.

Alexandra Dolezel is a Tax Director at PwC in Vienna and Maria Vasileva works in the Transfer Pricing practice at PwC in Vienna.

They can be contacted at:
alexandra.dolezel@at.pwc.com
vasileva.maria@at.pwc.com
www.pwc.at

Belgium

Dirk Van Stappen, Yves de Groote, and Eugena Molla
KPMG Belgium

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

While there are many different methods an analyst may consider, the Comparable Uncontrolled Price (CUP) method is still one of the preferred transfer pricing methods of the OECD and the Belgian tax authorities with respect to the pricing of intercompany funding.[1] In particular, where it is possible to locate internal comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arm's-length principle and to determine the prices for the related-party transactions.

The CUP method evaluates the arm's-length character of a controlled transaction by comparing the interest rate charged in the controlled transaction to the interest rate charged in a comparable uncontrolled transaction. This method may be used when data are available to establish the interest rate charged between unrelated-parties under similar circumstances. The resulting CUPs define an arm's-length range of interest rates that should be charged in the transactions occurring between related-parties.

Considering the substantial amount of publicly available information in relation to financial transactions between third parties, the CUP method appears to be the most appropriate transfer pricing method in determining an arm's-length interest rate for an intercompany loan. However, the application of the CUP method requires a high degree of similarity of the loans in determining comparability between the controlled and uncontrolled transactions. If there are no differences between the controlled and uncontrolled transactions that would affect the interest rate, or only minor differences for which appropriate adjustments can be made, then the CUP method will generally be the most direct and reliable measure of an arm's-length interest rate for the controlled transaction. If minor adjustments cannot be made, or if there are more than minor differences between the controlled and uncontrolled transactions, the CUP method may still be used, but reliability of the analysis in determining the arm's-length result will be reduced. If there are material differences for which reliable adjustments cannot be made, the CUP method may not provide a reliable measure of an arm's-length result.

In a Belgian context, two potential applications of the CUP method could be used, the first being the direct application, and the second a derivativee of the CUP method (hereinafter referred to as the "build-up" method).

Direct CUP method

Applied to financing transactions, the CUP method evaluates the arm's-length character of a controlled transaction by comparing the interest rate charged in the controlled transaction to the interest rate charged in a comparable uncontrolled transaction. This method may be used when data are available to establish the interest rate charged between unrelated parties under similar circumstances.

As stated above, application of the CUP method requires a high degree of similarity of the loans in determining comparability between the controlled and uncontrolled transactions. If there are no differences between the controlled and uncontrolled transactions that would affect the interest rate, or only minor differences for which appropriate adjustments can be made, then the CUP method will generally be the most direct and reliable measure of an arm's-length interest rate for the controlled transaction.

When defining an arm's-length interest rate for an intercompany loan, the Belgian tax authorities would take into account the following characteristics of the loan, amongst others:

- Purpose of the loan;
- Credit rating of the borrowing company;
- Amount;
- Currency;
- Maturity;
- Issue date;
- Country of the borrower/ lender;
- Interest rate type (fixed or floating);
- Collaterals (guaranteed or not);
- Subordination level;
- Fixed loan or loan facility; and
- Early termination clauses.

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Indirect CUP method or "Build-up" method

The "Build-up" method can be seen as an indirect application of the CUP method as it is subdividing an interest rate in different components, and is successively defining an arm's-length rate/spread for each component identified based on market comparables.

Applying the "Build-up" method, one will add-up various components to arrive to an interest rate that takes into account the various characteristics and specificities of the intercompany loan to be documented.

The building blocks to be taken into account should – or could – include the following:

- A base (risk free) rate;
- A company risk premium;
- A country risk premium; and
- Adjustments for subordination, guarantees, etc.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

There is no (un)official difference in the approach followed by the tax inspectors with regard to outbound and inbound transactions.

Furthermore, it is worth mentioning that, from a Belgian perspective, either abnormal or benevolent advantages received or granted could give rise to adverse tax consequences.

Where a Belgian enterprise grants an abnormal or benevolent advantage, the amount of the advantage is added back to the taxable base of the enterprise concerned unless the advantage is taken into account when determining the taxable base of the recipient of the advantage (cf. Article 26, Belgian Income Tax Code (BITC)). This should also be the case where the recipient is in a tax loss position. According to Article 207 BITC, tax losses and certain other tax attributes cannot be set off against income from so-called abnormal or benevolent advantages received from enterprises that are directly or indirectly related to the company receiving the benefit.

The Belgian company receiving the abnormal or benevolent advantage is not allowed to offset previous years' nor current year's tax losses nor other tax attributes from the profit corresponding to the received advantage. The Belgian tax authorities take the position that this results in the advantage being immediately taxed in the hands of the company receiving the advantage, irrespective of current year's or prior years' tax losses or other tax attributes available.

As such, the minimum taxable basis of a Belgian company includes the total amount of abnormal or benevolent advantages received. In the case of the adjustment, the tax loss carry forward is increased with the advantage effectively subject to tax.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

As with other intercompany interactions, intercompany funding should be priced according to the arm's-length principle, based on the terms that unrelated-parties would enter into similar agreements. Definitely, in building up a transfer pricing policy, one should support up-front the position that a third-party lender would have provided funding to the borrower, even in the absence of a guarantee, or that the borrower would have been able to fund itself in the market at the same conditions, without further guarantees, other than the implicit support of the group it belongs, if any.

The transfer pricing analysis begins by identifying the commercial or financial relations between the parties and the corresponding conditions and economically relevant circumstances, in order that the controlled transaction is accurately delineated. Delineation becomes increasingly relevant when it helps prevent situations where a Belgian entity, for instance, is retaining an overall negative interest spread in its dealings, given by the difference between the interest rates of its borrowings and the interest rates applied in its lending activities. Indeed, it is likely that a third party would not enter into different transactions that create an overall negative result in its hands.

Even in the case where associated parties have classified a financing instrument as debt, it should be assessed as to whether the tax authorities could disregard the transaction as such by proving, based on the general anti-abuse rule of Article 344 of the BITC, that the structure has been put in place with the specific objective of abusing the law.

While the automatic requalification of debt as equity – also based on the general anti-abuse rule as modified in 2012 – might require particular efforts in the hands of the tax authorities, the latter still have at their disposal additional ways to deny to the taxpayer the tax deduction with respect to interest paid:

- Thin capitalization rules; and/or
- Hybrid mismatch rules.

In any case, evidence showing that the borrower is expected to repay the loan is important. Similarly, documentation showing that the borrower would have the capacity to repay its debt is equally important.

The absence of a written agreement does not, per se, constitute a risk. Nevertheless, it should be pointed out that in the context of intercompany funding, proper documentation (e.g., agreements) that clearly identifies the pricing process and other terms and conditions (e.g., early repayment clauses) is important for substantiating the genuineness of the arrangement.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

A subsidiary generally receives some level of implicit benefit from its relationship with the parent entity. This benefit is referred to as the "passive association" benefit.

While, in accordance to the OECD,[2] an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger group of entities, and not to any specific activity being performed, the passive association should not be ignored when pricing intercompany funding.

The most commonly applied and accepted methodologies for taking into account the passive association, and thus the implicit guarantee, are provided by the Standard & Poor's (S&P)· and Moody's[4] reports with regard to credit ratings determination. These are also being followed by the Belgian Service for Advance Decisions in Tax Matters and by the Belgian tax authorities in general.

S&P characterizes a subsidiary over a range from core entity (i.e., fully integrated part of the group) to non-strategic investment. This, in turn, results in a range of support from substantial financial help to less or no financial help.

Similarly, according to Moody's, subsidiaries' credit worthiness could be corrected depending on the likelihood of the group/parent to support them. This is determined based on an implicit support analysis that, according to Moody's methodology, will improve the probability of default and therefore the associated credit risk.

There are 3 categories of implicit support (strong, medium or none) based on the following factors:

- Control (board representation, ownership)
- Strategic importance of the subsidiary
- Relative size of subsidiary vs. group in terms of assets, revenues, debt, equity investment, intercompany loans:
    - Reputational risk for the parent
    - Operational integration
    - Political and partner relationship
    - Size of the subsidiary vs. its market
- Regulation
- Track record of the parent

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

With specific reference to the indirect CUP method or the "build-up" method, as explained above, the following can have a direct impact on the credit worthiness of an entity:

— Country risk: a country risk adjustment should be performed on ta borrower's credit rating that is based on the "build-up" methodology, in order to reflect country-specific differences in interest rates. If the borrowing entity owns a significant number of assets in countries other than its own, the corresponding risk adjustment should also reflect this. A weighted average index should be used if the entity is multinational, i.e., active in different jurisdictions.

— Subordination: if an intercompany loan is subordinated, an upward interest rate adjustment should be performed in order to take into account the increased risk of default borne by the lending entity. In general, it would be considered appropriate to decrease the borrower's credit rating by one to two notches to take into account the subordinated character of the loan.[5] The impact of the subordinated character of a loan should be greater on medium to long-term loans due to the company's financial volatility over this period, as compared to short term loans where one has a better view on the evolution of the company's financial position.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Thomson Reuters® and Bloomberg® databases are frequently used by taxpayers to price their intercompany financing arrangements.

These databases are regarded as to be a valuable and reliable tools for identifying CUP transactions, when there are no internal CUPs available. The resulting CUPs define an arm's-length range of interest rates that could be applied to the intercompany loans to be documented.

Thomson Reuters® has bond coverage of corporate bonds, government bonds, preferred shares, mortgages, money market programs, syndicated loans and municipal bond. The database also provides detailed information on current deals in the market, deal pricing and market trends.

Taxpayers can use the Thomson Reuters® database to search for comparable transactions, based on issue date, maturity of the loan, type of interests (floating/fixed), redemption features/dates, credit rating (Moody's rating), collateral, the deal currency, the borrower region, exchanges, industry sectors and issuer types and security/market types.

Bloomberg® is a self-contained, stand-alone data feed that provides for a broad range of services. Bloomberg has that bond coverage of corporate bonds, government bonds, preferred shares, mortgages, money market programs, syndicated loans and municipal bonds, among others. Bloomberg® could be used to define arm's-length interest rates, introduction fees, guarantee fees, etc.

In the absence of an available public rating, a company's credit rating may be determined by using Moody's credit risk tool "RiskCalc®." This tool generates a forward-looking default probability by combining financial statement data and equity market information, resulting in a stand-alone credit rating estimation.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The corporate tax reform law of December 29, 2017, has introduced some certainty on the definition of "market rates" in the framework of Article 55 of the BITC on the deductibility of interest expenses. Article 55 now states that, for interest payments on non-mortgage loans with no fixed maturity, other than those paid to affiliated companies acting as a treasury center or under a centralized cash management agreement (e.g., a cash pool arrangement), as referred to in Article 198, paragraph 4, of the BITC, the market interest rate is linked to monetary financial institutions (MFI) interest rates. In particular, the "market rate" will be the one established by the National Bank of Belgium for loans granted for an amount less than EUR 1.000.000 to non-financial companies for less than one year, concluded in November of the calendar year preceding the calendar year to which the interest relates, increased by 2.5%. The rate so obtained represents the maximum interest rate to be applied.

Nevertheless, other than the provision discussed above, which does not cover all the intercompany financing arrangements, there are no safe-harbor rates or indications provided by the tax authorities in Belgium for financial transfer pricing purposes.

From a transfer pricing perspective, interest rates on intercompany funding should, generally, still be determined based on market data, taking into account the credit rating of the borrower and the maturity of the arrangement, in particular. Particular attention should be paid to arrangements entered into with related parties located in jurisdictions where suggested margins exist (e.g., Switzerland, the U.S., etc.), since an intercompany transaction, and an intercompany funding in particular, should always be assessed on both ends, including a sanity check on the Belgian side as well. While the interest rates applied might be prima facie acceptable in other jurisdictions, corroborative analyses based on actual market data should always be recommended in Belgium.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

When loan agreements or/and methodologies do not provide a rate "floor" on the base rate, it is likely that the Belgian tax authorities might conclude that in the interest rate calculation, the base rate should be capped at zero, to make sure that the interest rate is not less than the spread applied, or even less than zero.

In defense of the above view, it should be noted that capping the base rate at zero is also a common approach being followed by external banks when granting loans, thus giving a clear indication of the behavior of third parties in the market.

Deposit rates could be capped at 0, when and if negative rates apply, to incentivize the group entities to deposit at the level of the cash pool, if available. However, we observe that banks are also charging negative interest rates to their depositing clients. Hopefully, the OECD draft paper on intercompany financing to be issued later this year will provide further guidance in this respect.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Currently, interest expenses are, in principle, tax deductible insofar as thin capitalization limits (i.e., 5/1 debt/equity ratio) are respected and the interest is at an arm's-length rate.

However, the law on the corporate tax reform (Law of December 25, 2017) introduces, as from 2020, the Earning Stripping Rules (ESR) in Belgian law. These rules are based on EU ATAD I, and might potentially affect many corporates.

The ESR have similarities with thin capitalization, as explained under question 7 below, as both essentially focus on whether the amount of debt and, hence, the interest deduction is excessive. Thin capitalization determines the issue of excessiveness by reference to a debt to equity ratio. Under, the ESR, excessiveness is determined by referencing the quantum of a company's interest expense (intercompany and third-party) to its profit before tax.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

Through the Law of December 25, 2017, Belgium enacted corporate tax reform, which will take place in three steps in 2018, 2019 and 2020, and contains several major changes. One of the most important aims of the corporate tax reform is to neutralize the effects of hybrid mismatches. As such, Belgium has first introduced definitions of hybrid mismatch, hybrid entity and hybrid transfer in its tax law.

With respect to hybrid financial instruments, mismatches concern situations where the tax treatment of a financial instrument differs between two jurisdictions. A hybrid transfer means any arrangement to transfer a financial instrument where the underlying return on the transferred financial instrument is treated for tax purposes as derived simultaneously by more than one of the parties to that arrangement.

The newly introduced Belgian measures, which will be effective as of tax year 2020 (income year 2019), mirror the EU directive rules (namely primary and secondary rules) by foreseeing the following:

- Denying the deduction in the state of which the payer is a resident; and
- Including the payment in the country of the payee jurisdiction.

As an exception, in specific situations payments made by financial traders do not give rise to hybrid mismatches provided that certain requirements are met.

Additionally, according to the Belgian law, no hybrid mismatch is deemed to exist when the non-inclusion is due to differences resulting from the application of transfer pricing rules.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

From a Belgian standpoint, the authorized OECD approach on the attribution of profits to permanent establishments (PEs) indicated in the OECD 2010 Report on the Attribution of Profits to PEs (July 22, 2010) should be considered when assessing PEs and their dealings.

The authorized OECD approach states that "the profits to be attributed to a PE are the profits that the PE would have earned at arm's-length, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise."

However, in the presence of intercompany funding, and with specific reference to the determination of the creditworthiness of a PE, one should also make reference to paragraph 31 of the OECD 2010 Report on the Attribution of Profits, which states that, in general, the factual situation of a PE determines that it necessarily has the same creditworthiness as the enterprise of which it is a part. In contrast, a subsidiary may or may not have the same creditworthiness as its parent.

It remains to be seen whether the upcoming OECD guidelines on financing transactions will overrule/moderate this provision.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

As previously mentioned, a subsidiary generally receives some level of implicit benefit from its relationship with the group/parent company. This type of association and related benefit is deemed passive in nature and is increasingly recognized in Belgian transfer pricing cases.

However, an associated enterprise should not be regarded as receiving an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger group, and not to any specific activity being performed. For instance, no guarantee would be received where a related-party by reason of its affiliation alone has a credit-rating higher than it would if it were unaffiliated, but an intra-group guarantee would usually exist if the higher credit rating were due to a guarantee by another group entity, or if the enterprise benefitted from deliberate concerted actions put in place by the group or another group member.

In this respect, and in accordance to the OECD Guidelines, passive association should be distinguished from active promotion of the MNE group's attributes.[6]

Typically a guarantee enables less financially solid companies to borrow greater funds and/or at more advantageous rates than would be possible independently. The transfer pricing question arises as a guarantee is similar to an insurance policy in which the guarantor promises to meet the borrower's obligations in the event of a default. The price of the policy can be established based on the risks undertaken and profit margin taken in the market.

One of the commonly applied and accepted methods for substantiating the guarantee fee consists of the interest rate differential. The methodology aims at estimating the benefit of the guarantee to the beneficiary, i.e., by quantifying the lower interest rate charged by banks as a result of the guarantee. However, the outcome of this approach should be seen as a maximum, considering that a third party would not be ready to pay a guarantee fee that is higher than the advantage that it will receive from the lender through a lower interest percentage. In practice, through the interest rate differential, one should calculate the spread between what the guarantor and the beneficiary would have to pay for a similar loan in the market. The difference in credit rating between guarantor and the borrower is often taken as a basis for the quantification thereof.

Please note that a comfort letter might have little legally binding effect. The letter, indeed, gives no guarantee for the repayment of the projected loan but offers the bank the comfort of knowing that the subsidiary has made the parent company aware of its intention to borrow; the parent also usually supports the application, giving, at least, an assurance that it intends that the subsidiary should remain in business and that it will give notice of any relevant change of ownership.

A comfort letter, therefore, has little legal bearing on the obligations of the loan. It is therefore highly unlikely that a comfort letter constitutes a valuable service to the borrower that should be paid for separately.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

The corporate tax reform law, published in the Belgian official gazette on December, 29 2017, includes measures addressing interest deduction limits that will be effective as from assessment year 2021 (that is, for tax periods beginning as from January 1, 2020).

Through the corporate tax reform, the EU anti-tax avoidance directives (ATAD I and II) will be implemented. A limitation of deductible interest will apply for the greater of EUR 3 million or 30 percent of EBITDA (earnings before interest, tax, depreciation and amortization).

The new limitation will only apply to interest on loans concluded as of June, 17 2016. The current 5:1 thin cap rule will remain applicable to arm's-length interest payments for:

- Interest paid to beneficial owners located in tax havens (regardless of the date); and
- Intragroup interest paid pursuant to a loan agreement for which it has been demonstrated that it was concluded prior to June 17, 2016, and not "fundamentally" modified since then.

For the calculation of interest and EBITDA, an ad hoc consolidation will be made. While non-deductible interest will be transferable without limit to subsequent years, there is also the possibility of transferring it to other group companies. Finally, stand-alone entities and financial companies will be excluded from the rule mentioned above.

Dirk Van Stappen, Partner, KPMG Belgium; Yves de Groote, Director; Eugena Molla, Manager, Global Transfer Pricing Services, KPMG Belgium. They can be contacted at:
dvanstappen@kpmg.com
ydegroote@kpmg.com
eugenamolla@kpmg.com
https://home.kpmg.com/be/en/home.html

NOTES

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[1] It appears that in practice, the application of other methods is difficult considering the fact that those methods are rather focusing on tangible products or typical group services.

[2] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, paragraph 7.13, July 2017.

[4] Moody's Investors Service, The Incorporation of Join-Default Analysis into Moody's Corporate, Financial and Government Rating Methodologies, February 2005.

[5] Also in line with Moody's approach in its "Moody's Proposes Update to Notching Corporate Instrument Ratings Based on Differences in Security and Priority of Claim", July 2014.

[6] As stated during the 2017 OECD International Tax Conference, the OECD guidelines to be released on financing transactions will provide important guidance to multinationals on their intercompany funding, including cash pooling arrangements. The WP6 has already expressed its intention to produce extensive guidance addressing guarantees. It remains to be seen which positions will be taken with respect to implicit and explicit guarantees.

Brazil

Jerry Levers de Abreu, Lucas de Lima Carvalho, & Mateus Tiagor Campos
TozziniFreire Advogados, Brazil

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Brazilian transfer pricing rules establish that in *outbound financial transactions,* with foreign related parties or with a party resident in a tax haven (or subject to a privileged tax regime), the Brazilian legal entity acting as the lender must record a minimum interest amount for purposes of the Corporate Income Tax ("IRPJ") and the Social Contribution on Net Profits ("CSLL"). Conversely, in *inbound financial transactions* of the same type, the Brazilian legal entity acting as the borrower is only allowed to deduct interest due up to a specified statutory level (except if the borrower is subject to the Deemed Profit Regime of IRPJ and CSLL, which does not allow for deductions from the taxable base). If a Brazilian legal entity, subject to transfer pricing rules fails, to comply with either of those thresholds, apart from applicable interest and penalties, it will be subject to the collection of IRPJ and CSLL on the difference (at an aggregate rate of up to 34%).

The calculation of the minimum interest amount and the maximum interest expense is determined by Brazilian transfer pricing rules as a base rate plus a spread. Under the current rules, the base rate is:

(i) the "market rate for sovereign bonds issued by the Federative Republic of Brazil in foreign markets in Brazilian Reais" for loan agreements that are denominated in Brazilian Reais and have a prefixed interest rate,

(ii) the "market rate for sovereign bonds issued by the Federative Republic of Brazil in foreign markets in U.S. Dollars" for loan agreements that are denominated in U.S. Dollars and have a prefixed interest rate, or

(iii) the "LIBOR rate for 06 (six) months" for loan agreements that are denominated in currencies different than Brazilian Reais or U.S. Dollars, and/or have a post fixed interest rate (e.g., EURIBOR for 12 months).

The spread that is to be added to the appropriate base rate is currently set forth by Ordinance MF 427/2013 as **(a)** 2.5% for outbound transactions, and **(b)** 3.5% for inbound transactions.

It should be noted that this is the only method established by the Brazilian transfer pricing rules for loan agreements. Therefore, no other methods are applicable, either by the taxpayers or the Federal Revenue of Brazil ("RFB").

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

No. Officially, the only difference between the transfer pricing formula for outbound financial transactions as opposed to inbound financial transactions is the spread (currently, 2.5% or 3.5%). Tax inspectors do not (and may not) express a preference for any valuation method or approach other than the one established in applicable Law and commented above (their tax authority is bound by the statutory method described in applicable Law).

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

There is no specific definition in Brazilian transfer pricing rules for what constitutes a loan, but it is as-

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sumed (for transfer pricing purposes) that a loan must be the temporary transfer of cash resources from one party to another. Brazil has its own version of the General Anti-Avoidance Rule ("GAAR") in the Brazilian Tax Code ("CTN"), which basically allows tax authorities to disregard transactions of structures if they reveal lack of business purpose or economic substance. One could argue, therefore, that expenses incurred in the context of what is intrinsically an equity transaction should not be deductible at all (let alone be subject to transfer pricing rules). However, in practice, we have not seen administrative or judicial binding precedents in which a loan (even converted into equity soon thereafter) has been regarded as an equity transaction originally, and therefore not capable of rendering related expenses deductible for IRPJ and CSLL purposes.

In terms of interest-free loans, as commented above, if a Brazilian legal entity lends to a related party offshore (or to a party resident in a tax haven or subject to a privileged fiscal regime) cash resources without charging interest, a minimum interest amount will be factored into the taxable income of this Brazilian legal entity for IRPJ and CSLL purposes, in accordance with Brazilian transfer pricing rules. However, if the Brazilian legal entity in this example were to borrow cash resources without paying interest, that operation would not be recharacterized as an equity transaction simply by virtue of it being interest-free.

Additionally, in terms of loans without a written agreement, transfer pricing rules are in the category of "special deductibility rules" (for IRPJ and CSLL purposes, at the level of the Brazilian legal entity acting as borrower). Special deductibility rules are preceded by general deductibility rules, which require that expenses must be **(i)** usual, **(ii)** necessary for the maintenance of the productive source of the taxpayer, and **(iii)** effectively incurred by the payor (documented as paid). The fact that a loan agreement is not documented (even if the interest expenses themselves are documented as paid) may be used by RFB to write-off all interest deductions related to that loan.

Finally, there are cases in which RFB has questioned the deductibility of interest expenses on so-called "perpetual loans" (i.e., loans that either do not have a formal term or that are constantly renewed). These have been recharacterized by the tax authorities as equity, and have caused the issuance of tax assessment notices against the taxpayer for the corresponding amount of the deduction (unpaid IRPJ and CSLL), plus a fine of up to 150%, plus SELIC interest (currently set at 6.75% per annum).

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

A Brazilian legal entity in the context of an inbound financial transaction is considered, at first, as a standalone borrower. General and special deductibility rules (if applicable) must be observed by the Brazilian borrower, regardless if the inbound loan agreement is performed with a foreign related party or not. There is no assumption of implicit support from affiliated entities embedded into Brazilian transfer pricing rules, just the analysis of objective requirements for the characterization of "related parties" (or a tax haven or a privileged fiscal regime) for purposes of their application.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

Within Brazilian transfer pricing rules, there is no such thing as an analysis of the credit worthiness of a Brazilian legal entity acting as a borrower.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Given the statutory formula employed by Brazilian transfer pricing rules to control for minimum revenue and maximum expenses in cross-border loan agreements, no benchmarking would apply for a Brazilian legal entity subject to those rules (including a Brazilian legal entity acting as a borrower). A pseudo-benchmarking standard may be inferred from the base rates used in the statutory formula, but that standard is not in and of itself a benchmarking for cross-border loan agreements (i.e., the base rate does not provide a direct comparable to the interest rates in cross-border loan agreements between private entities).

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

There are no safe harbor rates for the Brazilian transfer pricing rules as applied to cross-border loan agreements. However, the spreads mentioned in our answers to question number 1 may be considered as "suggested margins", since these are considered as part of the transfer pricing calculation and are previously established in the Brazilian rules. In this regard, it should be noted that the spreads may be altered by the Ministry of Finance at any moment.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

There are no clear definitions by the RFB on this subject, however, the general view is that the statutory formula established in the Brazilian transfer pricing rules is not altered if the rate to be considered in the calculation is negative. Therefore, the calculation should be performed in accordance with the formula mentioned in question 1, regardless of whether the base rate is positive or negative. To date, there are no binding precedents from administrative or judicial courts stating otherwise.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Apart from general deductibility rules and from the Brazilian transfer pricing rules, the other set of rules that may apply to a cross-border, intra-group lending arrangement is the set of thin capitalization rules. In general terms, thin capitalization rules establish a maximum limit of indebtedness based on a multiple of net equity participation (or of the entire net equity of the Brazilian borrower). The general multiple is that borrowings may be up to 2 times equity, but, for tax havens and privileged fiscal regimes, that multiple drops to 30%.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

No changes have been made to Brazilian transfer pricing rules as applied to cross-border loan agreements recently (and, specifically, none have been made since the inception of the BEPS Action Plan). In the Final Report of BEPS Actions 8, 9 and 10, Brazil declared that it would maintain its current transfer pricing rules, using the Mutual Agreement Procedure ("MAP") to resolve any tax disputes associated to their application.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Under Brazilian Law, the PE of a foreign company in Brazilian territory is, in principle, regarded as a separate Brazilian legal entity (and taxable as such for purposes of IRPJ and CSLL). Therefore, the same deductibility rules applied to a Brazilian legal entity acting as a borrower in a cross-border loan agreement (including transfer pricing rules and thin capitalization rules) must be followed by Brazilian resident PEs. It is important to highlight that the concept of PE has been analyzed in only a handful of cases before administrative and judicial courts in Brazil. The application of the concept of PE by these courts, however, has not ventured into the subject of them being a "distinct and separate enterprise" for tax purposes.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Assuming that (i) the loan guarantee fee mentioned in this question does not encompass any interest expenses of the Brazilian entity, and (ii) that it is solely a remuneration, with or without a mark-up, for the guarantee of a potential non-payment event of the loan agreements by the Brazilian entity, for Brazilian tax purposes, this guarantee provided by a foreign related party is considered as a financial service rendered by the foreign related party to the Brazilian entity. Therefore, a loan guarantee that meets the assumptions presented above must be accounted for according to the applicable accounting rules for services rendered by a foreign party. As a general rule, these should be accounted for upon the starting term of the guarantee agreement.

With regard to the appropriate charge for this guarantee, it must observe the deductibility requirements mentioned in question 3, as well as the transfer pricing rules on the importation of services. Please note that, even though there are other transfer pricing methods applicable to the importation of services (i.e., the Comparable Uncontrolled Price ("PIC") method and the Resale Price Minus Profit Method ("PRL") method), the method that uses cost of production as its basis is the Cost of Production plus Profit Method ("CPL"). This method requires that the parameter price must be calculated as average cost of production plus source taxes plus a 20% profit margin.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Brazil has not adopted interest deduction limits in line with the suggested ratio or the group ratio approach proposed by the OECD. The interest deduction limits applicable to the IRPJ and CSLL payable by a Brazilian borrower in a cross-border loan agreement are generally described in our answers to questions 1, 3(a) and 3(g).

Jerry Levers de Abreu is a Partner at TozziniFreire Advogados, Sao Paulo; Lucas de Lima Carvalho is a Senior Tax Associate at TozziniFreire Advogados, Sao Paulo; and Mateus Tiagor Campos is a Junior Associate at TozziniFreire Advogados, Sao Paulo. They may be contacted at:
Jabreu@tozzinifreire.com.br;
Lcarvalho@tozzinifreire.com.br;
Mtiagor@tozzinifreire.com.br.

Canada

Richard Garland and Inna Golodniuk
Deloitte LLP, Canada

1. Does your country specify permissible methods for evaluating an arm's- length interest rate on related-party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

There are no legislative provisions or published administrative guidance on transfer pricing methods applicable to loan transactions. Specifically, neither Canada's Income Tax Act (the "Act"), nor circulars or memoranda by the Canada Revenue Agency ("CRA") contain rules that are specific to any transfer pricing aspects of loan transactions. Loan transactions should therefore be analyzed by applying the arm's-length principle, and in applying the arm's-length principle, the CRA endorses and follows the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TPG").

In practice, to meet the Canadian reasonable efforts standard,[1] the CUP method is commonly selected as the most appropriate method for supporting the interest rate on an intercompany financing transaction. In the authors' experience, CRA tax auditors typically do not challenge the appropriateness of the CUP method in the determination of interest rates for related-party loans. However, the CRA has challenged various aspects of how the CUP method should be applied. The CUP method is applied using data on internal or external comparable uncontrolled transactions. In this context, the CRA emphasizes the importance of transaction-level data and degree of comparability between the tested controlled transaction and the uncontrolled transactions. In the authors' experience, the CRA tends to dismiss the use of various non-transactional data, such as indices, market statistics, bank quotes, etc.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

Where a loan is subject to the transfer pricing provisions of the Act,[2] the same transfer pricing methodology is applicable to both inbound and outbound loans. In some instances, the practical application of the transfer pricing methodology by tax auditors might be influenced by whether a transaction is inbound or outbound. For example, depending on whether a transaction is inbound or outbound, tax authorities may seek to accomplish a more favorable (to them) outcome by challenging the determination of loan creditworthiness, selection of comparable uncontrolled transactions, or by advancing or denying comparability adjustments.

There are other (non-transfer pricing) provisions of the Act relevant to related-party loans that are more specific than transfer pricing provisions. As discussed further below, these more specific provisions allow Canadian companies, under certain conditions and circumstances, to provide interest-free loans and free-of-charge guarantees to controlled foreign affiliates[3] or to apply prescribed rates to calculate taxable interest income from loans extended to parent companies.[4]

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

As a general matter, it should be noted that stringent criteria must be met for interest to be deductible in

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Canada. A full discussion of the interest deductibility provisions is beyond the scope of this article.

From a Canadian transfer pricing perspective, section 247 of the Act allows the CRA to make a transfer pricing adjustment if a term or condition of any related-party cross border transaction differs from terms and conditions that would exist if the parties were at arm's-length.[5] In the case of an interest-free loan to a Canadian entity, the transfer pricing provisions of the Act would allow the CRA to adjust the rate to an arm's-length rate of interest (although, in the authors' view, it is unlikely that the CRA would propose an adjustment in the case of an interest-free loan to a Canadian entity).[6] The transfer pricing provisions of the Act would also permit the taxpayer to request a downward adjustment to the taxpayer's income (i.e., a deduction for interest). However, the CRA has discretion in deciding whether to permit such an adjustment, and it may decline such an adjustment if there was a concern that there would be a deduction allowed in Canada without an income inclusion in the jurisdiction of the lender.[7,]

If a transfer pricing adjustment exceeds stated thresholds and if the taxpayer has not made reasonable efforts to determine and use arm's-length pricing, the CRA can also impose a transfer pricing penalty. The penalty amount is 10% of the transfer pricing adjustment.[8]

There is no explicit rule requiring a written agreement to be in place.[9] In the authors' experience, most companies do prepare intercompany loan agreements, and instances where there are no written agreements are rare. The authors are aware of the CRA taking the position that in the absence of a written loan agreement, the terms and conditions can be inferred from the behavior of the parties, supplemented by an analysis of the terms and conditions prevailing in the market.

The law also allows the CRA to "recharacterize" a transaction when the following conditions are met:

- The transaction would not have been entered into between persons dealing at arm's-length and

- The transaction can reasonably be considered not to have been entered into primarily for *bona fide* purposes other than to obtain a tax benefit.

In order to recharacterize a transaction, the CRA must demonstrate both that arm's-length parties would not have entered into the transaction and that the transaction was undertaken primarily for a tax purpose. In practice, demonstrating both conditions appears to be a very high threshold for the CRA to meet.

In the authors' experience, the current best practice is to analyze market information on key terms and conditions that are expected to impact arm's-length rates of interest. Such terms and conditions may include principal amount, purpose, use of funds, term to maturity, security, subordination, embedded options, etc. These same considerations are relevant in supporting a *bona fide* purpose of the loan.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

Under the current case law, a borrower's overall creditworthiness is determined considering both stand-alone creditworthiness and implicit support of the multinational group.

Canadian transfer pricing jurisprudence had analyzed implicit support long before the OECD TPG acknowledged its relevance in the context of intercompany financing. In the *General Electric Capital Canada Inc.v.Her Majesty the Queen* ("*GE Capital* case"), the Tax Court of Canada ("TCC") dealt with a guarantee fee paid by a Canadian taxpayer, General Electric Capital Canada, to its US parent guarantor. A central component of the case was the appropriate method for determining creditworthiness of General Electric Capital Canada in order to establish credit enhancement from the guarantee. The TCC ruled that when assessing the creditworthiness of the subsidiary, it is necessary to consider the potential uplift due to support from the parent group that would exist in the absence of a formal guarantee.

Implicit support therefore stands as a common consideration in applying the arm's-length principle, rather than an exception, and an implicit support analysis became an integral part of transfer pricing of financial transactions. Conceptually, implicit support must be analyzed considering the parental willingness and ability to support the subsidiary in the event of credit distress.

The strength or relevance of implicit support is a factual determination. In performing such an assessment, practitioners generally rely on guidance available in the GE Capital case and in publicly available information provided by credit rating agencies. The guidance suggests that the parent's incentive to implicitly support a subsidiary depends on the subsidiary's strategic importance to the multinational group, the level of ownership and the integration of the business as indicated by factors such as shared brand name, reliance on centralized management and the overall interdependence of the parent and the subsidiary. The more interrelated, strategic and significant in size the subsidiary, the more likely it is that implicit support would be considered to exist and provide an enhancement to the stand-alone creditworthiness.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

In assessing the borrower's stand-alone creditworthiness, practitioners consider a number of factors, including the entity's historical, current and prospective financial position, the industry in which it operates and its position in that industry, business profile (e.g., size and diversification) and other factors related to the borrower's ability to maintain and enhance that competitive position.

Implicit support is taken into account to factor in the multinational group's willingness and ability to support the borrower in the event of credit distress.

After the borrower's stand-alone creditworthiness and implicit support are determined, the authors are not aware of any other factors that are relevant in evaluating borrower creditworthiness.

Beyond borrower creditworthiness, issue-specific creditworthiness of an individual loan is typically analyzed. Issue-specific creditworthiness evaluates the risk of default specific to that instrument only. Issue-specific creditworthiness is typically determined starting from the borrower creditworthiness and, if appropriate, adjusting for structural or contractual subordination.[10]

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Both internal and external transactional data is used:

- Internal uncontrolled transactions may be identified among transactions between the borrower (or a related borrowing entity) and external lenders (or between a related lending entity and external borrowers); and,
- External uncontrolled transactions, such as loan or bond issuances of suitable comparability, are normally identified through Bloomberg or Thomson Reuters' Loan Pricing Corporation's LoanConnector databases.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

Where a Canadian corporation borrows funds from a related non-resident, there are no safe-harbor rates or indicative rates. The rate must comply with the arm's-length principle.

As noted above, where a Canadian corporation makes a loan to a related non-resident person, there are certain non-transfer pricing provisions of the Act that might, in certain circumstances, be applicable and that would allow for either the use of prescribed interest rates or even the use of non-interest-bearing loans. If these provisions are not applicable, then the interest on the outbound loan would be required to be consistent with the arm's-length principle. The applicability of provisions that would permit the use of prescribed rate or non-interest-bearing loans must be carefully considered. These provisions are complex and a discussion of the provisions is beyond the scope of this article.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

Generally, where such transactions are subject to the transfer pricing provisions of the Act, transfer pricing analyses are performed by applying the same methodologies as for intercompany loans (i.e., a deposit is a related-party loan made to the deposit taker). Negative base rates are a relatively recent phenomenon and the authors are not aware of the CRA having considered these transactions. In the authors' opinion, considering that the North American market rates tend to be higher than the European rates, additional analyses beyond a one-sided transactional interest rate determination would be expected. Such analyses generally would identify and evaluate other alternatives realistically available to the Canadian lender and consider all of the lender's economically relevant circumstances.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Intercompany loans (inbound and outbound) are subject to a complex system of rules including withholding tax provisions, thin-capitalization rules and interest deductibility rules. A complete discussion of the non-transfer pricing provisions is beyond the scope of this article.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

To date, no legislative changes have been made to address hybrid mismatch arrangements. In the authors' experience, certain hybrid arrangements have been in use for a very long period of time with no history of challenge by the CRA. However, the authors are aware of other arrangements where the CRA is contemplating using the recharacterization provision to challenge the arrangement.[11] Historically, the recharacterization provision has been a very high threshold for the CRA to meet, and it remains to be seen whether the CRA will prevail in applying the provision in the future.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Under domestic law, a non-resident of Canada is subject to Canadian tax if that non-resident carries on business in Canada. In the absence of a treaty, the income of the non-resident is computed under the rules of the Act. As such, interest expense of a non-resident would only be deductible in computing the income of the branch if (amongst other criteria) it relates to an actual borrowing and it can be demonstrated that the borrowing can reasonably be considered to relate to the actual business operations in Canada. In addition, if the borrowing in question is a loan from a related non-resident person, then the transfer pricing provisions would also apply.

Under Canada's international tax treaties, Article 7 would apply to determine taxable income of a PE. Article 7 in most of Canada's treaties follows the OECD model tax treaty and permits PEs to deduct expenses incurred for the purposes of the PE,[12] and to attribute profits as if the PE were a distinct and separate enterprise engaged in similar activities under similar conditions and dealing independently with the rest of the enterprise[13]. The authorized OECD approach is often followed in interpreting and applying the distinct and separate enterprise principle.[14] However, to date, Canada's only agreement that explicitly acknowledges that parties will determine profits of PEs solely according to the authorized OECD approach is the agreement between the competent authorities of Canada and the United States.[15]

Administrative guidance by the CRA parallels the distinct and separate enterprise principle in the treaties. Specifically, the CRA is of the view that many of the transfer pricing principles and methods applicable to transactions between separate legal entities are also relevant to the attribution of income between a PE and other parts of the same entity.[16]

The implication in the context of inter- and intracompany financing is that the attribution of debt funding costs to a PE and the recognition and pricing of any loan dealings[17] are analyzed by applying the arm's-length principle and the OECD transfer methods by analogy.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Transactions in which a foreign affiliate explicitly guarantees debt obligations of a Canadian taxpayer (in this context, an "obligor") are analyzed predominantly from an obligor's perspective. An analysis from an obligor's perspective would be required to determine whether a guarantee transaction should be recognized and, if so, to determine an arm's-length guarantee fee.

The *GE Capital* case initially considered both the guarantor's and obligor's perspectives, but ultimately discussed and analyzed the guarantee solely from the obligor's perspective.

To determine whether a guarantee transaction should be recognized, a common consideration is a benefit test from the perspective of the obligor. A guarantee would be beneficial to an obligor only to the extent that it helps to achieve a lower cost of financing. If the cost saving is trivial, the guarantee would not be recognized (as it does not reach the transactional threshold).

Where a guarantee transaction is recognized, a separate guarantee fee must be determined. The CRA endorses the application of the arm's-length principle on a transaction-by-transaction basis and maintains that taxpayers should set prices separately for each transaction they enter into with a related-party. In the CRA's view, this separate price determination usually provides the most reliable estimation of an arm's-length price.[18]

Canadian analyses of guarantee fees are often one-sided and concentrate on the obligor's willingness to pay. The maximum amount an obligor would be willing to pay is typically determined as savings in costs of financing achieved due to the guarantee. This approach became widespread subsequent to the *GE Capital* case. The case ultimately relied on the so called "yield approach" to determine the value of a financial guarantee. The yield approach is agnostic to the economic considerations of a guarantor and views interest savings attributable to the guarantee as the fundamental determinant of arm's-length guarantee fees.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

To date, no recent changes in light of BEPS Action 4 limiting interest deductions have been introduced.

The ability of a Canadian subsidiary to deduct interest is subject to limitations under the domestic thin capitalization rules contained in the Act.[19] In very general terms, the rules provide that interest payable to certain affiliated non-residents is not deductible to the extent that the aggregate principal amount of all relevant debt exceeds 1.5 times the equity amount of the Canadian subsidiary. When an interest deduction is disallowed under the thin capitalization rules, it is then recharacterized as a dividend for the purposes of the Act.

Richard Garland is a Partner, Deloitte LLP, Toronto, Canada; Inna Golodniuk is a Senior Manager, Deloitte LLP, Toronto, Canada. They may be contacted at:
rigarland@deloitte.ca
igolodniuk@deloitte.ca
www.deloitte.com/ca

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[1] Transfer pricing penalties can be imposed if a taxpayer does not make a reasonable effort to determine and use arm's length transfer prices. "Reasonable efforts" is not defined in the Act, although subsection 247(4) deems reasonable efforts not to be made in the event that transfer pricing documentation containing the information as set out in subparagraphs 247(4)(a)(i) to (vi) is not prepared by the taxpayer's tax filing due date and provided to the CRA within three months of request.

[2] *See* below for non-transfer pricing provisions of the Act that, in certain circumstances, allow using prescribed rates or making interest-free loans.

[3] Section 17 of the Act.

[4] "Pertinent loan or indebtedness" is defined in subsection 15(2.11) of the Act. Interest imputation rules are set out in section 17.1 of the Act.

[5] Paragraphs 247(2) (a) and (c) of the Act.

[6] In the case of an interest-free loan by a Canadian entity to a related non-resident, the transfer pricing provisions of the Act would allow the CRA to adjust the rate to an arm's length rate of interest unless the loan meets certain criteria (for example, as discussed below, in very specific circumstances it is possible for an interest-free loan to be made to an entity that is controlled by the Canadian taxpayer, however, a full discussion of these provisions is beyond the scope of this article).

[7] Subsection 247(10) of the Act provides for the Minister of Revenue's discretion. Even if a downward adjustment is allowed under the transfer pricing provisions, it is debatable whether such interest is deductible. One of the criteria for interest deductibility is that the interest is paid pursuant to a legal obligation to pay interest on borrowed money – a test that would not be met in the case of an interest-free loan.

[8] Subsection 247(3) of the Act imposes a transfer pricing penalty, calculated as 10% of the transfer pricing adjustment (not the additional tax owing) on certain transfer pricing adjustments that increase the income of the Canadian taxpayer and exceed the lesser of $5 million or 10% of gross receipts.

[9] As noted above, interest is only deductible if there is a legal obligation to pay interest. While it is understood that, from a legal perspective, a verbal (i.e., non-written) agreement can be legally enforceable, it would always be prudent to have a written agreement to demonstrate that this criterion is met.

[10] Structurally or contractually subordinated debt instruments are those under which the claim on the company's assets or earnings is subordinate to other claims due to structural or contractual arrangements.

[11] Paragraphs 247(2) (b) and (d) of the Act.

[12] Paragraph 3 of article 7 of the OECD model treaty.

[13] Paragraph 2 of article 7 of the OECD model treaty.

[14] For the authorized OECD approach, refer to the report by the OECD titled *2010 Report on the Attribution of Profits to Permanent Establishments*.

[15] The CRA has asserted (on May 26, 2016, at the International Fiscal Association, Canadian Branch Roundtable, in the answer to question 2) that "notional" expenses are not deductible in computing income of a PE in the absence of an agreement to recognize and adopt the authorized OECD approach for the purpose of a specific treaty. This would suggest that the CRA would likely only allow a deduction for interest on an actual borrowing that can be specifically attributed to the branch.

[16] CRA, Information Circular 87-2R, "International Transfer Pricing."

[17] A "dealing" is an OECD term for an economically significant flow (transaction) between a PE and the rest of the legal entity (of which the PE is a part).

[18] CRA, Information Circular 87-2R, "International Transfer Pricing" and Transfer Pricing Memorandum -06, "Bundled Transactions."

[19] Subsections 18(4) through 18(8) of the Act.

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China

Cheng Chi and Rafael Triginelli Miraglia
KPMG, China

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related-party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

China's legislation expressly recognizes that the CUP can be applied to financial transactions. In the specific case of intercompany loans, tax authorities generally prefer the CUP, given that information on third-party comparable transactions is usually available in the public domain (e.g., through publicly available databases). To apply the CUP, it is critical to ascertain the creditworthiness of the borrower, either through ratings published by investment risk agencies or through analytical risk models for companies with no published credit ratings. The comparability criteria for financial transactions, as defined in the legislation, are the following: amount, currency, term, whether a loan is guaranteed, creditworthiness of the borrower, method of repayment, and method of calculating interest. Other factors such as location, purpose of the loan and date may be also considered in practice.

Albeit rare and confined to specific situations, there have been cases where taxpayers resorted to the Profit Split Method (PSM), particularly when multiple parties were involved in the loan agreement. Alternatively, the Cost-Plus Method (CPM) or Transactional Net Margin Method (TNMM) weighted on costs have also been used in rare and confined to specific situations when intermediaries are involved in back-to-back transactions.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

In applying the CUP, the tax authorities generally rely on the People's Bank of China (PBoC) benchmark lending rates as a parameter to assess the reasonableness of the interest component. Although there is no official position treating inbound loans different from outbound ones, as a practical matter, in most cases, the benchmark lending rate works as 'ceiling' rate for loans granted by foreign companies to Chinese affiliates (i.e., domestic borrower) or a 'floor' rate for loans granted by Chinese companies to overseas affiliates (i.e., domestic lender).

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

In China, tax authorities tend to be relatively strict in ascertaining whether a transaction constitutes genuine debt or equity, leaving little room for taxpayers to define the nature of sophisticated financial instruments. Hence, profit participating loans or transactions with contingent interest face a risk of being re-characterized as equity investment, for which a deduction is not allowed.

Generally, based on long-standing legislation and established administrative practice, debt transactions are at greater risk of challenge and re-characterization where the interest rate deviates substantially from the PBoC benchmark lending rates or if the terms of the financial arrangement include an open-end floating or contingent-interest component.

From a Chinese transfer pricing perspective, explicit credit support (e.g., guaranty agreement) generally requires an arm's-length guarantee fee to be charged by the guarantor to the guarantee recipient (i.e., the subsidiary receiving the funds), whereas incidental benefits from being part of a larger going concern do not typically trigger direct transfer pricing consequences.

In evaluating a borrower's credit-carrying capability, the factors set forth in the legislation that are also used to establish the comparability of loans, mentioned in the answer to question 1, are relevant. When an entity's or group's credit rating is not available as published by investment risk agencies (e.g., Moody's, Standard & Poor's, etc.), it is established practice to rely on analytical models such as Moody's RiskCalc™, to derive a credit rating, especially for private companies.

As discussed above, while China does not have statutory safe harbors with regards to financial transactions, the benchmark interest rates as published by the PBoC work in practice as parameter for assessing the reasonableness of interest rates.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

Due to stringent regulatory and foreign exchange constraints, tax planning through hybrid financial instruments has not historically been an issue of great significance in China. In practice, sophisticated and complex financial transactions are less common in China than in other jurisdictions. Nevertheless, there are ongoing efforts to effectuate anti-hybrid rules that are expected to draw on BEPS Action 2 developments.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

With regards to PE profit attribution, China has not endorsed the Authorized OECD Approach (AOA) set forth in the 2010 OECD report on the Attribution of Profits to Permanent Establishments. In effect, in the "Positions of Non-Member Countries" published with the 2010 Commentaries to the OECD Model Tax Convention, China has noted that "[w]hilst the People's Republic of China understands and respects the separate and independent enterprise principle underlying the new version of Article 7, due to its tax administration capacity it reserves the right to adopt the previous version of the Article and, in some cases, to resort to simpler methods for calculating the profits attributable to a permanent establishment".

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

When a (parent) company guarantees a debt (i) that the borrowing affiliate would not be able to secure on a stand-alone basis, or (ii) that the stand-alone borrowing affiliate would not be able to secure at the lower funding cost available to the guarantor, a guarantee fee should be charged to the borrowing entity by the guarantor of the debt.

While there are different approaches for determining the guarantee fee, in practice, the *reduced cost of funding* approach is the most widely used approach in China. Under this approach, a comparison is made between the funding costs for the borrowing subsidiary on a stand-alone basis and the reduced funding costs as a result of the guarantee. The difference sets the maximum that an independent party would be willing to pay for a guarantee in an arm's-length scenario, i.e., the guarantee ceiling. Typically, the guarantee fee would be established in such a way that the benefits (i.e., the delta) are apportioned between the parties based on economically relevant facts and circumstances.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

China has not adopted interest limitation rules in line with BEPS Action 4 and such rules are not a priority within China's tax policy agenda. With regard to thin capitalization rules, Circular 121/2008[2] introduced a maximum related-party debt-to-equity ratio, currently set at 5:1 for financial institutions and 2:1 for any other enterprises. Related-party debt in excess of the above ratios does not automatically lead to a disallowance of the corresponding interest expense. However, to claim the deduction when the debt- to-equity ratio is exceeded, the taxpayer must prepare, in addition to the annual Local File and Master File, a Special File on Thin Capitalization addressing the following items:

- *an analysis of the borrower's solvency and borrowing capacity;*
- *an analysis of the borrowing capacity and the financing structure of the group;*
- *an explanation of any changes in equity investment, such as the enterprise's registered capital;*
- *the nature, purpose and market situation of the related-party debt investment;*
- *the currency, amount, interest rate, terms and financing conditions of the related-party debt investment;*
- *analysis of whether a non-related party would be able and willing to accept the above financing conditions, amount of principal and interest rate;*
- *the conditions and terms of the collateral provided by the enterprise;*
- *the conditions of guarantor and terms of the guarantee;*
- *the interest rate and financing conditions of loans of similar nature and terms;*
- *the conversion condition of the convertible bonds; and*
- *other supporting documents that can prove compliance with the arm's-length principle.*

The Special File must be prepared in addition to the annual Local File and Master File.

Hence, the operation of thin capitalization rules, coupled with the established practice of relying on official benchmark lending rates, materially reduces multinationals' ability to erode their Chinese tax base through intercompany financing.

Cheng Chi is Head of Transfer Pricing, KPMG China; Rafael Triginelli Miraglia is Senior Manager, KPMG China. They can be contacted at:
cheng.chi@kpmg.com;
rafael.miraglia@kpmg.com;
https://home.kpmg.com/cn/en/home.html.

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[2] Circular of the Ministry of Finance and the State Administration of Taxation on Tax Policy Issues Relating to Pre-tax Deduction Standards for the Payment of Interest by Enterprises to Affiliated Parties, *Caishui* [2008] No. 121, issued on September 23rd, 2008.

France

Julien Monsenego and Camille Birague
Gowling WLG

Guillaume Madelpuech
NERA Economic Consulting

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Among the loan's terms and conditions, the interest rate will likely be one (and sometimes the only) component reviewed by the French Tax Administration (FTA). In such case, the FTA will probably use Article 57 of the French Tax Code (FTC), which provides for the general French transfer pricing (TP) provisions, if this is a cross-border financing. As a quick reminder, these provisions enable the FTA to reassess non-arm's length operations between related parties in an international context. The French TP rules specifically apply to cases where a non-arm's length transaction is carried-out between two related parties. In such situation, the taxable income derived by such an operation is determined by reference to the income which would have been derived between parties, had they been acting independently.[1]

The FTA may also use the concept of abnormal management act ("*acte anormal de gestion*") to disallow in full or in part the tax deductibility of interest expense of a French borrower (if it considers that the latter should not have agreed on the terms and conditions of the corresponding intra-group loan) or to recapture a portion of taxable interest expense of a French lender (if it considers that the interest rate applicable to the granted loan is insufficient). In these situations, the FTA would not have to apply a specific tax audit procedure and/or recharacterize the loan agreement, as long as the abnormality of the loan terms and conditions are demonstrated.

Should the FTA challenge the deductibility of all or part of the interest expenses, it will bear the burden of the proof and will have to demonstrate the abnormality of the terms and conditions of the challenged financing (except under the very specific conditions of an "abuse of law").

The abnormal management act will likely be used for intra-group financing operations involving French related parties only (and in exceptional cases financing operations between third parties), while Article 57 of the FTC will be used for operations involving non-French related parties.

Finally, the FTA may rely upon Articles 212-1.a of the FTC which sets a limit to interest deductibility as the upper of the two limits below:

Interest rate stated in Article 39-1-3° of the FTC

According to this article, the maximum rate is determined by reference to the annual average of the effective rates used by the credit institutions for loans granted to companies at variable rates, for a period exceeding two years. FYI, the applicable rates for the last two FYs were: 2.06% for the last quarter of FY 2016; 1.69% for the last quarter of FY 2017; 1.64% for the first quarter of FY 2018. This maximum rate is applicable to any financing between related parties, i.e. not only in a parent-subsidiary relationship but also between sister companies or companies indirectly held by the same end-shareholder.

"Market" Interest rate

Any interest in excess of either this maximum rate or of, if applicable, the "market" rate, is not tax deductible at the French borrower's level.

In practice, to determine "arm's length" or "market" rates, the FTA most often complies with the OECD Transfer Pricing Guidelines, and, accordingly, would typically abide by the Comparable Uncontrolled Price (CUP) Method, as defined in the OECD Transfer Pricing Guidelines.

Yet, it was also commonly observed that individual examiners would request, under the provisions of Article 212-1.a of the FTC, formal offers or quotes by banks or credit institutions in order to grant full deductibility for certain interest charges.[2] This position

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seems to have been recently disavowed through a number of case laws.[3] This should further facilitate the acceptability of the CUP method and of appropriate economic analyses by the FTA, as soon as the audit stage.

Finally, please note that interest expenses are also limited by French corporate income tax rules otherwise known as "thin-capitalization rules" (please see question 7).

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

In practice, it is not uncommon that, during the audit phase, the position taken by an individual auditor in one context seems to contradict a position taken by another auditor in a seemingly very comparable situation, but where the interests of the FTA would be reversed.

It is worth mentioning that the "Safe Harbor" rates (see Section 1), referred to in Article 39-1-3 of the FTC (2.06% for the last quarter of FY 2016; 1.69% for the last quarter of FY 2017; 1.64% for the first quarter of FY 2018) are often favorably considered, when documenting the inbound (domestic borrower) charges.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

Based on some case law from the French Supreme Tax Court ("*Conseil d'Etat*" or CE),[4] it is often considered that the FTA may not rely upon Article 57 of the FTC to challenge the financing policy, and in particular the use of debt vs equity.

Yet, in a number of situations, the FTA may supplement Article 57 or 212-1.a by the theory of the abnormal act of management. It enables the FTA to reassess a taxpayer on the grounds that certain of its operations would not be aligned with the interest of the entity. Accordingly, the theory of the abnormal act of management echoes certain OECD concepts such as the ones of "Options Realistically Available" or "Transaction Delineation."

As an example, the FTA successfully relied upon the abnormal act of management theory to reassess a taxpayer in a situation where an interest free loan has been set-up.[5]

More generally, the lack of written agreement exposes a taxpayer to have the repayment of the principal of a loan classified as a deemed dividend.[6]

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

In *General Electric* case,[7] the *Conseil d'Etat* has précised the elements of appreciation of the abnormal nature of the remuneration of intragroup loans as defined by Article 212 II of the FTC. The *Conseil d'Etat* has confirmed the approach under which the intrinsic rating of the borrowing company must prevail, and affirms that if the membership to a group can have an influence on the credit rating and therefore on the interest rate supported, this influence is not automatic and can only be apprehended from a detailed qualitative analysis of each of the factors taken into account in the valuation the credit risk of the subsidiary.

This decision confirms the solution adopted by the *Administrative Court of Appeal of Bordeaux* ("Cour administrative d'appel de Bordeaux" or "CAA") in the *Stryker Spine* case,[8] which is directly, not using the abnormal management act, but Article 57 of the FTC and the arm's length principle.

In practice, the level of implicit support may be analyzed in light of (i) the willingness of the parent company to provide support and (ii) the ability of such company to provide support. Rating agencies issue methodologies[9] to analyze the implicit support which may be helpful in this regard.

The typical factors to analyze the willingness of the parent company to provide support may include the consideration of:

- Intricacy of reputation;
- Operational integration; and
- Role of financial regulators

The typical factors to analyze the ability of the parent company to provide support may include the consideration of:

- Parental credit rating;
- Correlation of business conditions; and
- Magnitude of expected support.

In a recent judgment, the *Administrative Court of Montreuil*[10] ("Tribunal administratif" or TA) relating to the burden of proof incumbent on the taxpayer in the context of Article 212-1 of the FTC considered that the administration was unfounded to require the production of an offer of contemporary loan operations. The relevance of interest rates practiced can be demonstrated by economic studies based in particular on the intrinsic credit rating of the borrowing company. This position, even if it is only a decision of first instance, gives hope for a coherent approach for assessing the full competition nature of intra-group borrowing, regardless of the rule implemented (Article 39 or 212-1 of the FTC).

In the view of the foregoing, the intra-group interest rates on their cost of external financing should be monitored in consideration of these decisions.

It remains to be hoped that these decisions, which are in line with the OECD position, as it should be made explicit in the draft report on intra-group financial instruments expected this summer, and a significant number of tax administrations, are expressly accepted and applied by the tax administration to provide greater legal certainty in this area.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

Please refer to b. for the *Conseil d'Etat* approach adopted in recent case law.

The analysis of the stand-alone position as well as of any other relevant group effect should provide a reasonable ground to analyze the borrower's credit worthiness.

Please note that the consideration of the entity's borrowing conditions with third parties may often provide relevant reference points, in the context of the analysis.

Other aspects, such as the ones related to the financial instrument per se, are as well critical in the transfer pricing analysis.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

The FTA are believed to be routinely presented analyses using authoritative capital markets database sources, including, amongst other, Bloomberg, Reuters or Loan Connector.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

Please refer to question 2.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

The authors are not aware of any formal position taken by the FTA, as regards the context of negative interbank interest rates. Taxpayers should expect that the FTA would assess the appropriateness of the interest rates in light of the conditions which would have prevailed between unrelated parties.

We would typically recommend avoiding, as possible, to charge out negative interest rates to foreign borrowers. Nevertheless, we are that some French MNEs took the position to charge out negative intercompany interest rates, in certain circumstances.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Other important issues related to intercompany lending include, amongst other:

- Thin capitalization rules,
- Arm's length nature of the overall financing policy and tax characterization of the financial instruments,
- Features of the loan (e.g. convertibility, early reimbursement clause by the lender, by the borrower, etc.)

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

On August 5 2014, the French Tax Authorities (FTA) released their final regulations on the "anti-hybrid financing" provisions enacted as part of the 2014 Finance Bill.

The 2014 Finance Bill introduced, under Article 212 I (b) of the FTC, a new interest limitation rule (also referred to as "anti-hybrid financing" provisions) which provides that interest paid by a French enterprise subject to Corporate Income Tax (CIT) to a related French enterprise or a non-resident related enterprise is not tax deductible for French CIT purposes if the interest paid is not subject to tax, at the level of the beneficiary company, at a rate of at least 25% of the French CIT that would have been due under the standard French rules (Minimum Taxation Test).

This provision clearly aims at limiting interest deduction at debtor's level if such interest is not taxable at creditors level, notably if it is treated an excepted dividend or as a capital contribution reimbursement.

In the current French context, the specific thin capitalization provisions will likely be used by the FTA to assess the arm's length nature of intra-group financial transactions.

However, since such specific rules do refer to market rates, it is possible that the FTA and/or the concerned taxpayer have to use transfer pricing analysis to assess such market rate, using available benchmarks in data bases (see Issues One and Two above).

Reference can be made to the French Chapter of the Recharacterization topic of the BNA transfer pricing forum (Issue 1), in which we discussed two French case-law relating to loan versus equity qualifications, issued prior to Article 212-I b. of the FTC.

The concept was notably discussed in the *Stallergènes*[11] case recently, which deals with the traditional question of qualification of a single amount as equity in one country and debt in the other country. The operation has been legally qualified as a loan, the French Tax Authorities challenging the lack of interest on the operation and proceeded to a corresponding reassessment based on article 57 of the FTC (TP reassessment).

Another GSE case-law from the *Conseil d'Etat* acknowledges the right, for a French company holding a

Portuguese subsidiary, to make "supplemental contributions" as defined under Portuguese law and not request interest from the subsidiary, even if these contributions are financed in France by a loan, and provided they have been treated accounting wise as capital.[12]

These recharacterizations of debt into equity (or the reverse requalification) would of course impact correspondingly the thin capitalization rules applicable either to a French borrower or lender, or even to the entire Group, when such rules are applied at Group level.

Proof of the minimum taxation

Upon request of the FTA, French taxpayers must provide documentation supporting that the CIT applicable at the level of the lender on interest accrued and deducted by the debtor is at least equal to 25% of the CIT normally due under standard French CIT rules.

The draft regulations required the French debtor to evidence that the interest paid is effectively recorded in the profit and loss accounts of the lender (in addition to demonstrating that tax legislation applicable in the lender's jurisdiction provides for a sufficient tax rate on such interest). In the final regulations, the FTA require the debtor to evidence that it was actually included in the lender's taxable income, e.g., by providing both the accounting entries made by the lender and the lender's tax return.

Where the lender is part of a French tax consolidated group, the final regulations specify that it must be evidenced that the interest is included in the tax consolidated income. No specific comment is made for foreign tax consolidated groups.

Deemed dividend classification

French tax laws provide that certain non-deductible interest payments are classified as deemed dividends and may, thus, be subject to domestic dividend withholding taxes and a 3% dividend distribution tax. The final regulations provide that disallowance of interest under the "anti-hybrid financing" rule does not trigger such reclassification.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

The FTA consider that Article 212 II of the FTC rules apply to French permanent establishment of foreign Companies.[13]

In addition, the FTA precise that the breakdown of indebtedness between the permanent establishment and the foreign parent company has to comply with territoriality rules provided by Article 209, I of the FTC as well as the provision relating to profits in Bilateral Tax treaties.

This position contradicts the position adopted in several decisions by the French Tax Supreme Court according to which branches must be provided for equity capital or not at the option of each enterprise. In these decisions, it has been judged that the FTA were not allowed to reject the deductibility of interest at the level of French branches for a lump sum corresponding to the alleged equity capital these branches had to be provided for.[14]

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

A number of methods may be set forward to determine the appropriate guarantee charge:

- Actuarial method, relying upon the modelling of the Expected Loss associated with the calling of the guarantee. This method often relies, in particular, upon the consideration of:
  - The default probability of both entities;
  - The correlation between these default probabilities; and
  - The opportunity cost of capital.
- Credit Default Swap pricing

It happens that simpler approaches (direct comparison between the Group/parent borrowing conditions and of the Stand-alone borrowing conditions).

Based on our experience, the 50 basis point mentioned in particular case law[15] has sometimes been considered as an acceptable reference by field auditors, in the context of tax audits.

Similarly, pursuant to French tax case-law, a company granting a guarantee to a foreign related party without requesting any remuneration for such service has correspondingly transferred some of its profits to such related party. This profit can be reassessed under Article 57 of the FTC.[16]

However, if the company granting such guarantee is able to demonstrate that a specific counterpart has been derived from the guaranteed operation, it may justify the lack of any remuneration. In this respect, French case law has ruled that:

- the lack of remuneration on guarantee granted a French parent company on loans to a foreign subsidiary can be justified by the significant boost in sales of said subsidiary.[17] However, it is important to note the specific context of this case, since the local legislation applicable to the subsidiary was forbidding any remuneration on guarantee and the amount of unrequested fees for the guarantee was particularly low when compared to the increase in sales;
- on the contrary, such lack of remuneration is a transfer of profits which cannot be only justified by a mere increase in the value of the subsidiary to which the fee-free guarantee has been granted.[18]

Therefore, as a matter of principle, remuneration for guarantees should be requested, and it is only in exceptional circumstances, under which a clear counterpart/advantage to the granting party can be identified, that no fee could apply to the guarantee. This counterpart/advantage can be found in the commercial relationships between the parties (e.g., need to preserve the viability of the beneficiary if it is a supplier or a distributor of the grantor) and, less frequently, in their shareholder-subsidiary relationship (since a specific advantage for the party granting the guarantee is required, the sole increase in the value of the beneficiary throughout the guaranteed operation being viewed as insufficient to justify a lack of fee on the guarantee).

Other French case-law, not based on Article 57 of the FTC but on the abnormal management act, have set out the very same principles. It can notably be noted that within a network of supermarkets, a current member can grant a guarantee to a new member without requesting any remuneration, provided this lack of remuneration is grounded by its contractual commitments of sponsorship of new members toward said network.[19]

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Since 2007, the French government has adopted various rules providing a limitation of the interest paid to related-companies described below.

General financial expenses deduction:

As a reminder, the Finance Act for 2013 has introduced a general financial expenses deduction cap based on the amount of the net financial expenses incurred during a Fiscal Year (i.e., the financial expenses reduced by the financial income). Only 85% of the net financial interest incurred in Fiscal Years open on December 1st, 2012 and 2013 (for the UTC French companies), is tax deductible, and 75% for the expenses incurred in FY open on December 1st, 2014 and onwards.

In the case of a tax consolidated group, pursuant to Section 223 B bis of the French Tax Code, the financial expenses deduction cap applies to the net financial expenses of the tax group (excluding inter-company transactions), at tax group level only (i.e. no cap applies on a standalone basis, except for employee profit sharing computation purposes).

This financial expenses deduction cap does not apply if the net financial expenses incurred by the company or by the tax group during a FY are below 3 million Euros.

Scope of Article 212 of the FTC:

These provisions apply regardless of the location of the lender (French, EU resident or non-EU resident).

Article 212 applies to loans granted by direct or indirect shareholder of a French company, and also granted by companies belonging to the same Group, when directly or indirectly held by the same parent company.

Article 212 of the FTC provides however for some specific exceptions. French companies managing a cash pooling within a group, financial credit establishments, leasing institutions and financing in the course of normal commercial relationships, are not subject to these limitations.

Analysis of the interest rate and the level of global financial debt:

The interest expense borne by a French company for loans granted by its direct or indirect shareholder or by a related company is tax-deductible as a matter principle, but subject to two different limits: the applicable interest rate (See Question 1) and the level of financial indebtedness of the borrower and possibly the Group it belongs to (i.e., "thin capitalization rules").

The limitation of deductible interest will also apply when the three following cumulative conditions are met:

- The loans or current accounts from the direct / indirect shareholders or related companies having the same shareholder exceed 1.5 times the amount of the shareholders' equity (or the amount of the paid-up share capital, if superior);[20]
- The interest expense is higher than 25% of the operating income before tax increased by depreciation and interest expenses; and
- The intra-group interest expense borne by the French company is higher than the intra-group interest expense it received.

The interest expense is only deductible up to the highest of the three above-mentioned amounts.

The excess amount over the highest of these three limitations although not deductible for the current fiscal year can be carried forward over the following fiscal years. This excess amount remains deductible from the income of the following fiscal year, or from the next fiscal years, with a reduction of 5% per year of the carried-forward amount.

Besides, if the excess amount of interest is lower than 150 K€, the interest remains fully deductible when incurred.

Furthermore, the new limits will not apply when the French company can evidence that its level of indebtedness does not exceed the level of indebtedness of the group to which it.

Finally, in case of merger or contribution of business by a French company having an available amount of deferred deductible interest, such amount can be transferred to the merging or benefiting company when the operation is carried-out under the so-called French favorable Tax regime. Also, specific rules have been issued for tax-consolidated companies, which will not be developed any further in this analysis.

Although these specific rules have increased the limitation of interest deductibility, there is still room for leveraged structure in a French context. Therefore, the opportunities and associated risks in relation to leverage finance will remain and so the scrutiny of the FTA on such operations.

Mr. Monsenego is a Partner in Tax Law at Gowling WLG in Paris. Camille Birague is an Associate at Gowling WLG in Paris. Mr. Madelpuech is a Principal within the Transfer Pricing Practice of NERA Economic Consulting in Paris. They may be contacted at:
julien.monsenego@gowlingwlg.com
Camille.Birague@gowlingwlg.com
www.gowlingwlg.com
guillaume.madelpuech@nera.comhttp
http://www.nera.com

NOTES

[1] Last paragraph of article 57 of the FTC.

[2] BOI-IS-BASE-35-20-10-20140415 n°110.

[3] CE, June 19, 2017, GE Money Bank; Administrative Court of Bordeaux, November 13, 2014, Siblu ; Administrative Court of Montreuil, March 20, 2017, Sté BAS.

[4] CE, Sect., December 30, 2003, rec. N°233 894, SA Andritz.

[5] CE July 31, 2009 SARL Domaine Ste Claire and SARL Jean Marc Brocard.

[6] CAA Nantes June 14 2010, Slobic.

[7] CE, 9e et 10e ch., June19 2017, n° 392543, min.c/ Sté General Electric France.

[8] CE, September 2, 2014, No. 12BX01182, Stryker Spine Company.

[9] Such as Moody's (2003) Rating non-guaranteed subsidiaries.

[10] TA, March 30, 2017, No. 1506904, BSA company.

[11] TA Paris, December 31, 2008, n°03-9446 and 04-22396, *Stallergènes*.

[12] CE, September 7, 2009, n°03303560, *SNC Immobilière GSE*.

[13] BOI-IS-BASE-35-20-10-20140415 n°10.

[14] CE, April 11, 2014, n°346687, 10e and 9e s-s., Sté Unicredit – Banca di Roma Spa; CE, April 11 2014, n°344990, 10e and 9e s-s, Bayerische Hypo and Vereinsbank AG, CE, April 11, 2014,n°359640, 1àe and 9e s-s., Caixa General de Depositos.

[15] CE n°342753, October 5, 2011, SA Sofitec.

[16] CE, March 9, 1979 (n°10454).

[17] CE, March 3, 1989 (n°77581).

[18] CE, February 17, 1992 (n°81690-82782), Carrefour.

[19] CE, September 26, 2001 (n°219825), SA Rocadis.

[20] This ratio being determined at the opening or at the closing of the concerned fiscal year, depending on the French company's choice.

Germany

Alexander Vögele, Philip de Homont, and Georg Dettmann
NERA Economic Consulting, Frankfurt, Germany

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Germany has had detailed rules on financial transactions since the 1980s.

The Administrative Principles[1] ("*Verwaltungsgrundsätze*") of February 23, 1983, deal with the determination of interest and guarantee fees on the basis of the arm's-length principle, and are still in force today. Several other rules on the general deductibility of interest were based on debt-to-equity ratios and have been replaced by the limitation of interest deductibility (Art. 4h of the Income Tax Code[2] and Art. 8a of the Corporate Tax Code).[3]

Several court cases tried to determine the arm's-length character of interest: the Federal Tax court decisions of February 28, 1990,[4] and January 19, 1994,[5] are the most important cases. The 1990 case determined the interest rate by using the spread between the debit and credit rates of banks and tried to develop a system of functional analysis and of a certain "mean." This court decision has been superseded by OECD and also by national developments.

As well, some state tax courts have issued noteworthy decisions, e. g., the Lower Tax court of Munster's decision that certain external CUPs may not be used to benchmark interest rates on intercompany loans (December 7, 2016).

Many German taxpayers analyze functions and risks; perform shadow ratings on the basis of Standard & Poors, Moody's or Fitch, followed by CUPs from Bloomberg, Thomson Reuters and others.

Federal field tax auditors often do not accept CUPs from banks, arguing that banks have other market conditions, functions and cost structures that differ from finance companies. Therefore, CUPs from banks as well as bonds must be adjusted by taking into such differences. These adjustments should be reflected in the documentation of the taxpayer.

Field Tax Auditors often question the role of finance companies. Can the equity be attracted by the functions and risk-taking by the management of the finance company? Or do the operating companies use the finance company as a common vehicle without its own entrepreneurial function? In such cases field tax auditors want to apply the external interest rate of the finance company to the final operating company.

Field tax auditors frequently question the right remuneration of guarantees, which often leads to discussions about the distinction between explicit guarantees, implicit guarantees and the "backing in the group."

In general, such issues can be solved if the case is well prepared in the documentation of the taxpayer.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

German transfer pricing guidelines do not make a general distinction between valuation methods for inbound and outbound finance transactions respectively.

However, the formal framework (beyond valuation aspects) can be significantly different between inbound and outbound transactions. On the one hand, the limitation of interest deductibility ("interest barrier"/ "*Zinsschranke*," Art. 4h of the Income Tax Code and Art. 8a of the Corporate Tax Code) only limits the deduction of a German taxpayer, i.e., while outbound interest payments are formally limited, there is no restriction is placed on interest payments within Germany.

Moreover it should be noted that Article 1 of the German Foreign Tax Act (*Auszensteuergesetz*) only opens the possibility correcting transfer pricing that has led to an underreporting of the German tax base. This is not strictly speaking a distinction between inbound and outbound transactions, but it does mean that auditors can only make unfavorable adjustments - either by decreasing the interests paid by a German taxpayer, or by increasing the interest paid by a foreign entity.

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In practice, tax inspectors use similar methods to assess inbound and outbound transactions, although they more frequently question the substance of foreign financing entities. The main exception is the court ruling mentioned above in the answer to question 1. Since this decision typically would imply lower interest payments, tax inspectors more often try to apply it to cases where the German entity makes the interest payments.

Interestingly, German CFC Rules[6] mean that financial transactions that have no direct relation to a German entity, but are conducted between foreign subsidiaries, can also be scrutinized in Germany. In other words, German transfer pricing rules can have consequences to transactions that are neither inbound nor outbound. This is somewhat more important for financial transactions, since they are more frequently seen as 'passive" income according to these rules.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

Discussions about debt-to-equity ratios dominated German field tax audits for many years, but lost importance due to the introduction of the new interest deductibility rules. The new law on interest deduction applies only to interest expense exceeding interest income plus 30 percent of EBITDA (Art. 4h of the Income Tax Code and Art. 8a of the Corporate Tax Code). There are escape clauses, e.g., in cases where the debt/equity ratio of the taxpayer is not lower than the group ratio. Therefore, questions about an equity infusion are now rare in Germany.

The question as to what extent a loan would have been granted by an unrelated lender, leads to the question as to what interest rates should be applied. Therefore the comparability of interest rates must be examined.

If the loan from foreign group companies is interest free, then, in general, the German field tax auditors will not react because they are not obliged to audit the transfer prices in favor of the taxpayer.

If no written agreement exists, there must be a distinction between cases where oral agreements or memorandums exist and cases where no agreements at all exist. Only the latter may lead to the non-deductibility of interest expense when the loans are from countries with which the tax treaty does not reflect the OECD Model Tax Treaty terms.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

The passive association (backing) by the group cannot be remunerated, according to German principles. The relevant criterion for determining whether the borrower profits from implicit support is to assess what strategic importance the borrower has to the group. If it is a vital part of the group's supply chain, implicit support may increase the shadow rating of the borrower and lead to lower interest rates. One should further be examine whether the financing entity, is part of a concerted group action or is an entity that acts like a bank.

In the first case, a stand-alone rating and corresponding yield rates should not be applied because the business profile of the lender differs substantially from the financing by a bank.

In the second case, a stand-alone rating might be applied but should be adjusted for implicit support (if applicable), (structural) subordination and other relevant parameters. The rating methodology should be made transparent and be well-documented.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

The German Administrative Principles ("*Verwaltungsgrundsätze,*" para. 4) require that the evaluation takes into account what would have been charged by third parties for a similar credit on the money or capital market. Each case must take all relevant considerations into account. In particular the following should be examined:

1. Credit level and period;
2. Type and purpose of the credit;
3. Security and creditworthiness of the debtor (taking special terms into account that third parties would also have granted to the debtor entity as a member of a group of companies);
4. The currency of the credit, the exchange risks and chances and any hedging costs;
5. The refinancing costs of credits passed on; and
6. Other circumstances of the granting of the credit, especially the conditions on the capital markets.

To estimate the Security and creditworthiness of the debtor, further aspects should be taken into account.

First, liquidity aspects need to be considered. An intercompany loan is not as easy to resell as a publicly traded bond would be when liquidity is needed, i.e. it is more difficult to sell a shareholder loan in the open market, when liquidity is needed, as it would be to sell a market traded bond. This lack of liquidity needs to be reflected in the interest rate and therefore, an adjustment must be made.

Secondly, aspects of (structural) subordination need to be considered. In practice, internal loans tend to be subordinated to external creditors (e.g., priority debt), i.e. internal debt could be substantially disadvantaged. This structural subordination should be reflected in the interest rate applied.

Lastly, in cases where the comparable data obtained derives from loans denominated in a different currency, interest rates must be adjusted for the fact that different interest rates apply to different currencies.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

The usual databases, such as Bloomberg or Facstset can be relied upon. Wherever possible, internal CUPs should be used. In the German Administrative Principles - Procedures, the German tax authorities explicitly refer to the use of interquartile ranges ("*Verwaltungsgrundsätze-Verfahren*", para. 3.4.12.5, 2005[7]).

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

German tax law does not provide any safe harbor rules for interest rates in a TP context. However, the German interest deduction limitation rule on shareholder loans restricts the allowable net interest expense to 30% of EBITDA.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

German tax legislation does not explicitly deal with negative interest rates. However, since negative interest rates reflect the monetary environment, and thus the economic circumstances a stand-alone company would be confronted with, TP considerations should be based on the best alternative available for the taxpayer. It therefore needs to be analyzed whether the lending company could achieve a positive interest rate, despite base rates being negative.

From the borrower's perspective, the consideration would need to be the interest rate it actually faces in the (non-bank) credit market, given its risk profile. Despite negative base rates, borrowing entities are typically faced with interest charges when taking on debt. A similar rationale applies to cash-pooling arrangements.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

The interest deduction limitation rule on shareholder loans restricts the allowable net interest expense to 30% of EBITDA (Art. 4h of the Income Tax Code and Art. 8a of the Corporate Tax Code). Escape clauses apply, e.g., in cases where the debt/equity ratio of the taxpayer is not lower than the group ratio. However, this rule has been subject to several legal proceedings in the past and is currently under investigation by the German constitutional court.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

German family-owned groups traditionally rely on partnership structures. These partnership structures are prone to Hybrid Mismatches, in particular with regard to the qualification of funds as loans or equity. These mismatches helped to equalize structural weaknesses of such groups by deducting interest payments twice. Some of these structures have been made obsolete by the new art. 4i of the Income Tax Code.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Which approach is applied depends on the actual double tax treaty in place between the countries involved. Historically, Germany leaned more towards a "Relevant Business Activity Approach" rather than the "Separate Entity Approach." However, as of 2013, Germany formally adopted the Separate Entity Approach. This measure moved German transfer pricing of PEs from an extreme point on the spectrum of international conduct towards the international consensus.

Article 5 of the German Annual Tax Law made extensive changes to the principal German law on transfer pricing matters, the German Foreign Tax Act. Most importantly in this context, the Foreign Tax Act now explicitly extends the arm's-length principle to the attribution of profits to PEs. Since PEs cannot enter into a formal contract with another part of the same entity, the concept of fictional contracts ("dealings") when no actual contracts exist is introduced into the law.

The PE and the entity it belongs to must be treated as if they were separate entities. The German tax legislation,[8] requires an analysis of the functions performed, assets owned and risks assumed ("FAR") in the PE. An auxiliary calculation must be made that attributes the relevant liabilities to the PE. In the next step, the expenses must be attributed to it. In order to attribute any expenses to a PE, the presence of significant people in the PE is strictly required. In the absence of such significant people, no expenses can be attributed to a PE.

Chapter 2 of the German "Ordinance on the allocation of profits of permanent establishments" ("*Betriebsstättengewinnaufteilungsverordnung*") explicitly deals with special provisions for financing of PEs. It defines the special attribution rules that apply to financing PEs.

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6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

A guarantee fee is necessary if the guarantee predominately serves the interest of the recipient of the guarantee ("business reasons"). On the other hand if the guarantee is predominately in the interest of the guarantor ("shareholder reasons"), e.g., as a business enabler in a certain jurisdiction, the corresponding fee would not be tax deductible.

This is referred to in the German Administrative Principles for the Determination of Income (*Verwaltungsgrundsätze*, para. 4.4.1, 1983),[9] which state that guarantee fee payments are only tax deductible if the business reason for a guarantee lies outside the shareholding relationships.

This needs to be tested based on the capital structure of the company receiving the guarantee (would they have been operational otherwise? Would it have been possible to take on debt without the guarantee?).

If a guarantee fee is required, a range of arm's-length prices for such guarantees can be determined by applying financial valuation techniques, such as:

- The Expected Loss Approach (taking into account the (joint) default probability of both entities, and more specifically on the correlation of defaults of the two entities); or the
- The Credit Default Swap Approach, relying on financial data.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

As already outlined above, the German tax law defines an interest deduction limitation rule on shareholder loans. This rule ("*Zinsschranke,*" Art. 4h of the Income Tax Code and Art. 8a of the Corporate Tax Code) restricts the net interest expense to 30% of taxable income before EBITDA. It formed the basis for the OECD considerations regarding interest deduction limits.

However, despite being followed by the OECD, this rule has been subject to several legal proceedings in Germany. The German Federal Fiscal Court ("BFH"), in its decision of October 14, 2015, considered the current German interest limitation rule to not be in line with the German constitution and sent it to the German constitutional court. This could have the ironic result of the interest barrier getting abolished in Germany, despite it becoming an international standard.

Dr. Alexander Voegele, Philip de Homont, and Georg Dettmann all work at NERA Economic Consulting, Frankfurt, Germany. They may be contacted at:

alexander.voegele@nera.com

philip.de.homont@nera.com

georg.dettmann@nera.com

http://www.nera.com

NOTES

[1] *Grundsätze für die Prüfung der Einkunftsabgrenzung bei international verbundenen Unternehmen*.

[2] § 4h ESTG.

[3] § 8a KStG.

[4] BStBl. II 1990, pp. 649 *et seq*.

[5] BStBl. II 1994, pp. 725 *et seq*.

[6] *Hinzurechnungsbesteuerung*, laid out in § 8 of the *Auszensteuergesetz*.

[7] *Grundsätze für die Prüfung der Einkunftsabgrenzung zwischen nahestehenden Personen mit grenzüberschreitenden Geschäftsbeziehungen in Bezug auf Ermittlungs und Mitwirkungspflichten, Berichtigungen sowie auf Verständigungs-und EU-Schiedsverfahren*.

[8] Paragraph 2.1.1, of the "*Verwaltungsgrundsätze Betriebsstättengewinnaufteilung*."

[9] *Grundsätze für die Prüfung der Einkunftsabgrenzung bei international verbundenen Unternehmen*.

Hong Kong

John Kondos and Irene Lee
KPMG, Hong Kong

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related-party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The Hong Kong Inland Revenue Department (IRD) does not specify which transfer pricing method should be used to evaluate interest rates on related-party loans; however, the CUP method is considered to be most appropriate method to analyze the "interest rate charged on an inter-company borrowing between associated enterprises," according to the IRD's Departmental Interpretation and Practice Notes – No.46 (DIPN46).[1] That being said, the IRD will accept other transfer pricing methods, so long as the methods demonstrate that the related-party loans were carried out at independent commercial rates of interest.

Based on our observation, companies in Hong Kong tend to establish the interest rate between related parties, using one of three methods. First, companies may utilizes references to loan quotes or proposal offers by third-party commercial banks. However, by itself, this approach is typically insufficient to justify the arm's-length nature of the related-party lending interest rate.

Another way to establish the interest rate is through a benchmarking analysis. This is accomplished by identifying comparable loans or bonds, using the borrower's credit rating, either by notching down from the group's actual or a synthetic credit rating.

For the more bespoke funding arrangement, such as quasi-equity financing, the weighted average cost of capital may be used to determine the rate of return that may be earned by the lender. This analysis is very fact and circumstances driven.

When applying the above-described methods to determine the interest rate for related-party loans, the taxpayer should maintain proper documentation, such as credit rating analysis and benchmarking reports, market data, etc., to explain to the IRD on how the interest rate is in line with 3rd party commercial rate.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

The IRD does not express preference over the transfer pricing method or valuation approach selected to value outbound and inbound financial arrangements. It should be noted that Hong Kong adopts a territorial source principle of taxation, and only interest arising in or derived from Hong Kong is subject to Hong Kong profit tax. As clarified in DIPN 13, for simple loans, the "provision of credit" test could be used to determine the place where the credit was provided to the borrower (i.e. the Hong Kong entity).

In situations where the related-party loan is entered into between a Hong Kong lender and its related-party borrower *in Hong Kong* ("onshore loan"), the interest income derived will be subjected to Hong Kong profit tax.

When a related-party loan is entered into between a Hong Kong lender and its related-party borrower *outside of Hong Kong* ("offshore loan"), the interest income derived by the lender from the arrangement would generally be exempt from Hong Kong profit tax. The borrower is not entitled to a corresponding interest expense deduction in Hong Kong. Since offshore loans are not subject to profits tax in Hong Kong, it is uncommon for the IRD to challenge the transfer pricing policy for these loans.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

In the past, the IRD has seldom questioned the "bona fides" of a related-party loan or whether the related-party loan is in fact an equity infusion, but the IRD is stepping up its review on related-party financing. In particular, the IRD has been paying more attention on onshore loans and interest-free loans particularly now with the TP regulations coming into effect in Hong Kong.

While the absence of a related-party loan agreement does not, by itself, form a basis to question the genuineness of a related-party loan, lack of a proper agreement or supporting documentation will be challenged by the IRD if the department were to perform a tax audit. As such, it would be prudent for taxpayers to defend against challenges by the IRD, by ensuring proper documentation is maintained to substantiate the commercial reason behind related-party lending.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

Currently, the Hong Kong Inland Revenue Ordinance ("IRO") and the IRD do not specify how interest rate on related-party loans should be determined. However, as explained in Part (1), above, the interest rate between related parties should be carried out at commercial rates with sufficient comparability.

Theoretically, to determine the rate, the borrower's credit rating should be evaluated on a stand-alone basis. However, implicit support by or synergy with other group entities may be taken into account when the borrower is of critical strategic importance to the group or when there are overriding considerations, such as market practice of credit rating agencies, the cost of lending, credit spread between the lender and the borrower etc.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

When evaluating the credit worthiness of a borrower, it might be necessary to assess geographic conditions and qualitative factors, such as future profitability, asset and liability ratio, etc.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Ideally internal comparables should first analyzed to determine their comparability to the related-party loan in question. Factors that can influence whether internal comparables are used include the credit worthiness of the borrower, date of loan inception, tenor, loan size, currency, etc. If differences exist between the internal comparables and the loan in question, and those differences cannot be accurately adjusted, or internal comparables are not available, external comparables will be used to establish and assess the arm's-length interest rate for related-party loans.

When performing external searches, loan and bond data provided by independent databases, such as Bloomberg or Thomson Reuters, are applied to the analysis.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The interest on related-party loans should be established based on commercial rates of interest, which is dependent on the factors provided in Part 3(d), above. The IRD does not provide any safe-harbor rates for intercompany lending, and the IRD is not likely to provide such guidance in the near future.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

The Hong Kong Interbank Offered Rate has never fallen below zero, and we have never encountered a similar situation. That being said, considering the issue of negative interest, the intention behind negative interest might be critical factor. A negative interest rate is a monetary policy adopted by governments to stimulate lending in order to increase inflation and strengthen the economy. When we consider the interest rate for related-party loans, all factors, such as the true cost of lending, risk of default etc., should be accounted for. In the context of deposits, such as in a cash pooling scenario, the same can be said, and one must distinguish the true underlying independent party pricing from the government policy influencing pricing, and how such should be accounted for.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Based on our past experiences, we are not aware of any significant issues in relation to intragroup lending arrangements.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

As a member of the inclusive framework, Hong Kong is committed to implementing a BEPS package that includes the four minimum standards: countering harmful tax practices (Action 5), preventing treaty abuse (Action 6), imposing CbC reporting requirements (Action 13), improving cross-border dispute resolution mechanisms (Action 14). Hong Kong is also committed to establishing measures that are necessary for the implementation of these BEPS package initiatives. Does this retain the meaning that you intended?

Confirm

While the Hong Kong government will continue to monitor emerging international developments that are intended to combat profit shifting, at this time, the Hong Kong government is not planning to implement BEPS Action 2 (Hybrid Mismatch Arrangement).Does this retain the meaning that you intended?

Confirm

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Hong Kong has been incorporating the Authorized OECD Approach (AOA) for comprehensive avoidance of double taxation agreements ("DTA") with treaty partners, and the Hong Kong government intends to incorporate the AOA into the new Hong Kong transfer pricing legislation. While there are no cases or guidance on how the attribution of income to PE works with the rules of debt financing, the issue will likely be addressed by the IRD through the publication of new DIPN in the future.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

While the IRD does not express its view on whether payment of a guarantee fee is necessary when an explicit loan guarantee is provided, as explained in Part 3(b), above, a borrower should be evaluated on all the factors that can influence the final interest rate.

If a foreign affiliate provides an explicit loan guarantee to a Hong Kong borrower, with proper documentation to support the validity of the explicit loan guarantee, the Hong Kong borrower may make a payment to the guarantor by reference to benchmarking analysis and benefits tests that aim to explain the beneficial impact of the guarantee provided. The payment should generally be accepted by the IRD for tax deduction purpose.

It should be noted that guarantee fees should only be charged to the year in which they were incurred. Companies should not make retroactive adjustments.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Hong Kong has few limitations on the deductibility of interest expense. Insofar as interest payable for a loan entered into between a person (other than a financial institution) or an overseas financial institution is subject to Hong Kong profit tax, the corresponding interest expense can be deductible from the assessable profits.[2] Other than the above-stated limits, Hong Kong does not impose thin capital or other restriction on interest deductibility.

John Kondos is a Partner of Global Transfer Pricing Services, KPMG Hong Kong; Irene Lee is a Director of Global Transfer Pricing Services, KPMG Hong Kong. They can be contacted at the following email(s):
john.kondos@kpmg.com
irene.lee@kpmg.com
kpmg.com/cn

NOTES

[1] Departmental Interpretation and Practice Notes (DIPNs) such as DIPN46 are non-legally binding documents that are published by the IRD to provide an explanation on different tax matters.

[2] *See* IRO section 16(2)(c).

India

Rahul K. Mitra
KPMG, India

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The Indian transfer pricing regulations do not provide for any specific method to be followed for benchmarking of financial transactions in the nature of loan. However, as a matter of practice both taxpayers and revenue authorities have been applying the CUP method for determination of arm's length interest rates on related party loans.

In the initial years of transfer pricing developments in India, both taxpayers and revenue authorities adopted non-binding bank quotes for benchmarking inter-company financial transactions. As the acceptance of bank quotes became difficult with increasing sophistication of the revenue authorities, taxpayers have shifted towards a systematic approach for benchmarking the financial transactions.

In case of a loan transaction, the process typically commences with estimation of the credit rating of the borrower. In their analysis, taxpayers undertaking systematic analysis determine the arm's length price for financial transactions by evaluating the creditworthiness of the borrower on a stand-alone basis, factoring in the implicit support of membership in a multinational group (if any). The next step is to identify comparable uncontrolled transactions with borrowers having a similar credit rating. In addition to the credit rating, key terms and conditions of a loan transaction, such as currency in which the loan is made, country of the borrower, tenure of the loan, guarantee and security on the loan, if any, are also required to be comparable. The result of the economic analysis provides comparable loan arrangement information against which the arm's length nature of the tested loan transaction can be determined.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

The Indian regulations do not provide a specific preference for valuation based methods or approaches for benchmarking of financial transactions. Even as a matter of practice, valuation methods are seldom adopted by the Indian revenue authorities. However, revenue authorities do tend to adopt a different approach for benchmarking of outbound transactions vis-à-vis inbound transactions.

The rate of interest on any loan comprises of two components, namely base rate, which is a function of the currency of the loan, and the spread, which is a function of the credit rating of the borrower and terms and conditions of the loan. The Indian revenue authorities have been challenging the rate of interest on outbound foreign currency loans by applying the rate of interest prevailing in India. This approach has been posing serious challenges for taxpayers as it leads to incongruous results and makes the arrangement unviable from a business perspective. While the revenue authorities have been applying interest rates prevailing in India to benchmark foreign currency loans, the judicial precedents have been providing a different view. There has been a spate of rulings wherein courts and tribunals have held application of domestic prime lending rates as inappropriate for benchmarking foreign currency loans.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

The Indian transfer pricing regulations do not require any specific written agreement for any international transactions between related parties. However, under the exchange control regulations, it is necessary to have an agreement in place for borrowing.

Secondly, there is no specific provision under the transfer pricing regulations which focuses on examining the genuineness of the debt lent by the related party. There have been a few rulings of the Income Tax Appellate Tribunal ("Tax Tribunal"), in which the Tax Tribunal has focused on a borrower's apparently limited ability to borrow at arm's length to test whether the borrower would have taken a lesser sum or nothing.

At the moment, the Indian revenue authorities do not test the amount that any borrower would have been able to borrow in its own right to disregard guarantees in issues like an increase in the level or extent of overall debt due to the guarantee. However, it is anticipated that with the passage of time as a more sophisticated approach for benchmarking loans and guarantees is adopted, the following questions would also be addressed, in addition to the credit rating evaluation exercise and comparable loan searches:

- Whether the loan or guarantee would have been made at all in the absence of special relationship;
- The effect of a guarantee could also be a larger loan obtainable, and this may be more than the borrower would be able to or willing to take on at arm's length;
- Whether as independent parties, the lender and borrower could have entered into such an arrangement and whether they would have done so;
- Whether the loan or the guarantee is performing an equity function and therefore the interest or any guarantee should not be charged;

It is also heartening to see that with regard to the circumstances when a loan or guarantee is performing an equity function and therefore the interest or any guarantee should not be charged, although in the context of inability to lend coupled with the business expediency and not the ability to borrow, has found acknowledgement from the Indian Tax Tribunals.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

The notching up[1] on account of implicit support is a common financial industry practice in India and internationally, but it does not come as a default to every multinational group or as a default to every subsidiary to the same multinational group and needs to be analysed taking several parameters into consideration. The commonly adopted parameters have been listed as:

- common business of parent and subsidiary;
- size of investments in the subsidiary;
- economic incentive to the parent;
- shared name with the entity
- shareholding of the promoter group or the control over the entity;
- legal and regulatory obligations for the parent to support subsidiary;
- implicit support/ letter of comfort;
- parent and subsidiary domiciled in the same country;
- track record of the group of supporting other companies;
- parent's rating; etc.

Broadly, one can infer from the public information in the market, that the notch up criteria will have to consider the parent's own credit rating, its willingness to extent support to the subsidiary depending upon the level of integration between the parent and subsidiary, along with parent's ability to extend support to the subsidiary.

Taxpayers undertaking systematic analysis have determined the arm's length price for financial transactions by evaluating the creditworthiness of the borrower on a standalone basis *factoring* the implicit support. Most of the judicial precedents in India are in situations where the taxpayers adopted bank quotes or rates available in bank websites as comparable. The systematic approach of benchmarking transactions which involves estimation of credit worthiness and determination of appropriate comparables is yet to be tested before the Indian judicial authorities, even though there have been comments in some of the rulings suggesting a systematic approach.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

The factors that would be taken into account may be found in the response to issue 3(b) above.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

There are no specific databases used by the Indian revenue to benchmark financial transactions. As stated in the responses above, the Indian revenue authorities have been using bank quotes from various sources (bank websites etc.) for benchmarking inter-company financial transactions. The taxpayers on the other hand have been using financial databases such as Loan Connector, Bloomberg, Moody's Risk Calc, etc. to search for comparable loan agreements. There is, however, no guidance or case law in India which suggests the use of any particular source of data.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The Indian revenue authorities have issued notification providing safe harbor rates for certain transactions. The guidance in respect of financial transactions is as follows :

Provision of loan by Indian parent entity to foreign associated enterprise ("AE")

CRISIL credit rating of AE	**Loan in INR** Interest rate ≥ one-year marginal cost of funds lending rate of the State Bank of India as on 1st April of relevant previous year, plus	**Loan in Foreign currency** Interest rate ≥ six-month LIBOR of relevant foreign currency as on 30th September of relevant previous year, plus
■ between AAA to A or its equivalent	175 bp	150 bp
■ BBB-, BBB or BBB+ or its equivalent	325 bp	300 bp
■ between BB to B or its equivalent	475 bp	450 bp
■ between C to D or its equivalent	625 bp	600 bp
■ Credit rating of AE not available and aggregate amount of loan advanced to all AEs as on 31st March of the relevant previous year < INR 1 billion	425 bp	400 bp

Provision of guarantees by Indian parent entity with respect to foreign AE

Guarantee fees charged to be 1% or more per annum of the amount guaranteed. However, the credit rating of the borrower must be certified by the Securities and Exchange Board of India (SEBI)'s registered agency and such rating must be of the highest safety (for amounts guaranteed > INR 1 billion).

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

India has not introduced any modifications to transfer pricing rules for financial transactions, or to take account of hybrid mismatch arrangements, so far.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

In the tax treaties negotiated by India, payments in the nature of interest by a permanent establishment to its Head Office are not allowed as a deductible expenditure. However, an exception has been provided in the case of banking companies, for which an amount paid by a permanent establishment to the head office, by way of interest is an allowable expenditure. As such, there are no prescribed rules in India for allocation of fee or debt capital for permanent establishments.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Provision of a guarantee is regarded as a service under the Indian regulations and a guarantee fee must be accounted for unless the guarantee can be demonstrated to be in the nature of shareholder function. However, when a foreign affiliate has provided a guarantee on behalf of the Indian company, the requirement as laid down under the regulations is that the payment for a guarantee fee must be less than or equal to the arm's length price.

Determination of a guarantee fee is a complex process, and involves an analysis of the following factors:

- the type of guarantee, i.e. financial or performance; and
- nature of guarantee, i.e. implicit (no guarantee fee is payable) or explicit (guarantee fee is payable).

Generally, an explicit guarantee fee is determined using either the "interest saved" approach or the "risk of loss approach." The "interest saved" approach is the more commonly adopted method, and commences with a determination of the interest rate at which the borrower could have obtained the loan without provision of a guarantee. That interest rate is then compared to the rate at which the loan has actually been obtained. The saving in interest is attributed to the provision of the guarantee; and is split between the borrower and lender to determine the guarantee fee.

The "risk of loss" approach is much more complex and is based on the expected loss to the guarantor in case of default by the borrower company. Under this approach, two variables are estimated to calculate the guarantee fee, (i) the assets at risk; and (ii) the risk of loss factor. The determination of the risk of loss factor involves estimation of the creditworthiness of the borrower and determination of the expected default frequency (EDF) of the borrower, based on its creditworthiness. The difference between the value of the guarantee provided and the liquid assets of the borrower is the amount at risk for the guarantor. The amount at risk is multiplied by the EDF to determine the loss to the guarantor in case of default. The expected loss is multiplied by return on capital employed, which provides the expected return for the guarantor.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

India has recently introduced provisions for the limitation of interest deductions, as suggested under OECD/G-20 BEPS Action 4, in the hands of an Indian taxpayer on borrowings obtained from its foreign AE or even from third parties, which are backed by – (a) either implicit or explicit guarantees given by the foreign AE or (b) by deposit of matching funds by the foreign AE, to 30% of cash profits, namely earnings before interest, depreciation, taxes and amortization. Indian companies or branches of foreign companies, engaged in the business of banking or insurance have been exempted from these restrictions, as borrowings of funds constitute the core businesses of these entities. The shortfall, if any, in the deduction for interest under the aforesaid formula, can be carried forward for eight fiscal years.

Rahul K. Mitra works for Dhruva Advisors LLP. He can be contacted at:
rkmitra@kpmg.com
http://www.dhruvaadvisors.com/

NOTES

[1] Acknowledging a higher credit rating of the subsidiary company on account of the implicit support of the parent.

Ireland

Catherine O'Meara
Matheson, Ireland

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The primary Irish transfer pricing legislation is contained in Part 35A of the Taxes Consolidation Act 1997 (the "TP Legislation"). The TP Legislation requires transfer pricing rules to be construed consistently with the OECD Transfer Pricing Guidelines. Currently, the TP Legislation provides that the 2010 OECD Transfer Pricing Guidelines apply for evaluating whether an arm's-length interest rate applies to an arrangement. The TP Legislation does not specify acceptable or preferred transfer pricing methods for evaluating an arm's-length interest rate on related party loans. In accordance with the 2010 OECD Transfer Pricing Guidelines, the taxpayer should select a method that is most appropriate for a particular transaction. There is no Irish case law or specific Revenue guidance in respect of the suitability of any particular method. In practice, Revenue take a pragmatic view and will accept a methodology if it can be shown that the method is reasonable in the circumstances of the case and in line with the 2010 OECD Transfer Pricing Guidelines.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

The TP Legislation formally endorses the 2010 OECD Transfer Pricing Guidelines and, therefore, the methodologies applied under the OECD Guidelines should be applied in both outbound and inbound transactions pursuant to legislation. In practice, the Irish Revenue Commissioners try to be consistent in their approach to applying the 2010 OECD Transfer Pricing Guidelines to all similar transactions and, thus, it is expected that they would apply similar valuation methods to both inbound and outbound transactions that are similar in their facts and circumstances. This also ties in with the Irish Revenue Commissioner's obligation to treat taxpayers fairly.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

There is no specific Irish legislation or case law with respect to intercompany loans. If a loan falls within the scope of the TP Legislation as a trading activity of the company, the provisions of the legislation will apply.

With regard to loans, it is likely that Revenue would look at such matters as:

§ the amount and duration of the credit;
§ the debtors credit rating;
§ the securities provided; and
§ the industry in which the debtor operates

when considering what constitutes an arm's-length rate. The Irish Revenue Commissioners would use the typically available information sources used by transfer pricing professionals in analyzing transactions and would not generally seek to apply secret comparables.

The TP Legislation ensures that an arm's-length interest rate is charged subject to the proviso that an adjustment will only be made where the Irish company has understated income or overstated expenses. Once the TP Legislation applies, there are no safe harbors. Typically, Revenue will follow the OECD approach in this regard.

While there are no safe harbor rates contained in the TP Legislation, the transfer pricing rules do not apply to small or medium-sized enterprises (broadly, less than 250 employees and with a turnover of less than €50 million or assets of less than €43 million on a group basis).

Importantly, the TP Legislation applies only to trading or professional operations and the taxpayer must first prove that the expense is incurred wholly and exclusively for the purposes of its trade in order to obtain a tax deduction for that expense. Therefore, it should be possible for a company to make an interest-free loan when this is outside the company's trading activity.

Generally, under Irish law the legal nature of a contract is respected unless the provisions of Irish general anti-avoidance legislation can be applied to the contractual arrangements. Therefore, it is unlikely that the Revenue Commissioners would seek to recharacterize a loan arrangement as an equity transaction. However, Irish law does have specific legislation that recharacterizes certain types of interest in limited circumstances under the Taxes Consolidation Act 1997 (TCA). For example, intercompany interest in respect of securities of the company is recharacterized as a distribution if certain conditions are met under section 130 of the TCA, including interest that relates to loans with equity type characteristics (e.g., convertible loans or interest linked to profits).

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

Ireland has not yet implemented rules that affect transfer pricing of financial transactions in light of BEPS Action 2 on Hybrid Mismatch Arrangements. However, as an EU member state, Ireland is required to adopt laws and regulations necessary to comply with the Anti-Tax Avoidance Directive's anti-hybrid rules by December 31, 2019, at the latest.

However, it is worth noting that prior to the BEPS Project, Ireland incorporated anti-hybrid mismatch principles into the securitization regime set out in Section 110 of Taxes Consolidation Act 1997.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

A non-Irish resident company that is trading in Ireland through a branch or agency is subject to tax in Ireland on any trading income arising directly or indirectly through or from the branch or agency, or any income from property or rights used by, or held by or for, the branch or agency.

There is no guidance from the Revenue Commissioners on how to determine what trading income arises directly or indirectly through a branch or agency. However, the Revenue Commissioners will typically accept an allocation determined on a just and reasonable basis that is applied in a consistent manner. In this regard the Revenue Commissioners would typically apply the separate enterprise theory as provided for in most of Ireland's double tax treaties and would seek to apply arm's-length principles.

In an Irish context, this typically results in the branch or agency being treated as a fictitious separate legal entity so that income and gains are attributed to the branch or agency as if it were entering into arm's-length transactions with all outside parties (including the head office and other branches of the non-resident company). In general, deductions are not available for notional expenses and, therefore, while the allocation of certain head office costs to the Irish permanent establishment may be deductible, any mark-up charged by the head office would not be deductible by the Irish permanent establishment.

Ireland has no "force of attraction" rule. For non-resident companies, if income does not arise from the conduct of a trade in Ireland through a branch or agency, no Irish corporation tax will apply to it. There are no deeming provisions aggregating Irish-source income unrelated to such trade.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

There is no formal reference to explicit guarantees in the Irish TP Legislation. In determining whether any charge and what level of charge should be made for an explicit guarantee, all of the facts and circumstances should be considered. A deduction should be available if the taxpayer is able to prove that the expense is incurred wholly and exclusively for the purposes of its trade.

Where an Irish company is paying a guarantee fee in the course of its trade, the TP Legislation and the general rules as to the deductibility of expenses will seek to ensure that the guarantee fee charged is not excessive. However, no adjustment will be made where the Irish company is paying a less than arm's-length guarantee fee.

The following transfer pricing factors should be considered in respect of guarantee fees:

- existing guarantee fees paid to third parties by group companies may represent a suitable comparable; and
- generally, the Comparable Uncontrolled Price (CUP) method should be used where available. However, when the CUP method or other pricing methodologies are not applicable, the Revenue should accept a reasonable alternative pricing methodology determined in a commercial manner. This is a matter that needs to be considered on a case-by-case basis depending on the particular facts and circumstances.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Ireland does not have any specific interest deduction limits, such as the OECD's suggested group ratio approach, but some provisions in the Irish tax legislation can deny a full deduction for interest payments in certain circumstances. For example, under section 81 of Taxes Consolidation Act 1997 (TCA), a deduction for interest is allowed only to the extent that borrowings are used for the purpose of a trade or acquisition of certain non-trading assets. While Irish legislation does allow a deduction for interest incurred in relation to certain capital/non-trading transactions, there are significant anti-avoidance rules in place that limits the scope of these provisions.

Additionally, Ireland has some thin capitalization like rules. Section 130(2)(d)(iv) of the TCA is the one notable provision in the context of thin capitalization. It provides that in certain situations interest payments may be reclassified as distributions and they are therefore not tax deductible. There are broad exclusions and opt outs from the provisions of section 130(2)(d)(iv) of the TCA.

An Anti-Tax Avoidance Directive has been adopted at EU level and it will require Ireland to introduce a cap on interest deductions available to a taxpayer where net interest exceeds 30% of EBITDA. Ireland is availing itself of a derogation and will not introduce the implementing legislation until January 1, 2024.

Catherine O'Meara is a Partner at Matheson in Dublin and may be contacted at:
catherine.omeara@matheson.com
http://www.matheson.com

Israel

Yariv Ben-DovHerzog
Fox & Neeman, Israel

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related-party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

With respect to related-party financial transactions, the provisions of Section 85A of the Israeli Tax Ordinance ("Section 85A" or the "Israeli TP Regulations") explicitly address intercompany credit transactions (loans) and capital notes. However, in practice all types of financial arrangements[1] between related-parties must be transacted on an arm's-length basis, taking into account the parties' ability to receive funding or guarantees in the market. This should be analyzed from both the lender's and the borrower's perspective.

The arm's-length principle in the context of intercompany loans means that a controlled loan transaction is deemed to have met the arm's-length standard if its terms (e.g., principle amount, payment frequency, duration and any special features) and its results (i.e., interest rate) are consistent with those that would have been entered into by independent parties under similar circumstances.

This means that the evaluation of an intercompany loan is done by establishing an arm's-length interest rate based on interest rates applied in comparable third-party transactions.

In this regard, the Israeli TP Regulations do not provide specific guidelines for evaluating the arm's-length nature of intercompany loans and thus follow a broader transfer pricing approach provided under the OECD Guidelines and the regulations under Section 482 of the US Internal Revenue Code ("U.S. Regulations").

According to the OECD and the US Regulations, the transfer pricing methodology usually used when setting arm's-length interest rates for intercompany loans is the *CUP method applying internal or external CUP analysis*.

Internal CUP is applied in cases where these are comparable loans entered between the borrower and an external third party (usually a bank), that employ similar terms and conditions under the same circumstances as those existing at the time of the construction of the intercompany loan. However, this method is usually deemed inapplicable due to differences in terms and conditions that could not be reliably adjusted or the lack of similar arrangements with third parties.

External CUP is applied in two (2) ways:

i. Establishing an arm's-length interest rate benchmark by reference to the interest rate applied in current comparable financial transactions *concluded between unrelated entities*, and that incorporate similar features, including loan type, geographic location of the borrower, currency, principle amount, payment frequency, interest type, duration, industry of the borrower and any other special features.

This is done by identifying comparable loan agreements and using their interest rate to establish the arm's-length benchmark.

ii. The first step is to establish the credit rating of the controlled borrower, usually by applying a synthetic rating, and then applying the External CUP by reference to the market yield curve of bonds with the same credit rating, that incorporate the same features of the intercompany loan:

- Loan Type
- Borrower's Industry
- Tenure (time to maturity)
- Fixed/Floating Rate
- Currency
- Embedded Options (loan convertible to equity or option for repaying/collecting before maturity)
- Senior/ Subordinate Debt
- Collaterals and Guarantees

The establishment of the arm's-length benchmark is done by raising and lowering by one notch of the established credit rating of the borrower in the controlled loan transaction and then matching to each credit rating the market interest rate. These rates serve as the benchmark spread to be applied on a risk-free interest rate basis.

From our experience, the External CUP incorporating the credit rating process is the method most commonly used and accepted by tax administrators in Israel and, is thus considered the most effective.

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The results of an External CUP constructed by reference to comparable uncontrolled loan agreements are liable to not be accepted by the Israeli Tax authority (the ITA), but still could serve as cooperative method for the establishment of the interest rate benchmark when applying the External CUP, portrayed above in item ii.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

As previously noted, the approach preferred by the ITA is the External CUP Method which is in fact a Market valuation method as it relied when establishing arm's length interest rate on market yields of publicly traded corporate bonds that are comparable to the assessed intercompany loan in terms credit-rating and loan terms.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

As stated above, the arm's-length basis for intercompany loans is established by determining arm's-length interest rates.

The changes in tax and transfer pricing rules brought by the OECD under the BEPS project has created a sense of urgency for MNEs to revisit their loan arrangements in order to be able to defend the pricing of the intercompany loans.

Because the ITA has endorsed the BEPS Action Plan and is carrying out tax audit in the spirt of BEPS, it is very important that intercompany loan transactions be properly constructed and documented in accordance with the BEPS Actions 8-10 guidelines.

Accordingly, a number of steps must be carried out when evaluating the arm's-length nature of an intercompany loan:

- Properly delineating the controlled transaction with the focus on the lender's functionality over the whole period of the loan and its ability to control the financial risks associated with the funding.

This is very important and must be backed by empirical evidence gathered by the lender for supporting the management and control of financial risks associated with the intercompany loan. In the absence of empirical evidence, or if it has been proven that the lender doesn't control the financial risk, a risk-free return must be applied. Even worse, if e.g., the transaction is not commercially rational, then the guidance on non-recognition applies.

Audit trails/empirical evidence may include for instance: the number of FTEs on the payroll of the lender; a creditworthiness analysis of the borrower conducted by the lender; evidence of negotiation of the clauses to the intercompany loan agreement; etc.

- Analyzing the borrower's creditworthiness, referring to its credit risk (performing a synthetic rating) and its ability to obtain a principal amount from an outside lender that is similar to that of the intercompany loan.

When establishing the borrower's synthetic rating a stand-alone approach applies in order to reflect the borrower's probability of default arising from its own financial condition. This should reflect the borrower's ability to receive credit if it was not a member of a multinational group;

- Verifying that the controlled transaction meets the definition of debt under the relevant local tax rules/case law.
- Making sure the terms and conditions of the intercompany loan (e.g., principal, payment frequency, interest rate, duration, currency and any other special features) are consistent with those that would have been agreed between two independent third parties, taking into consideration the current market conditions.
- Setting the arm's-length benchmark according to the established borrower's synthetic rating (as described in question no. 1).

In conclusion, due to the adoption of BEPS by the ITA, Israeli taxpayers are advised to apply a new approach when establishing arm's-length interest rates for their intercompany loan transactions. This will combine the synthetic rating approach backed by audit trails and empirical evidence – such as a description of people functions involved and evidence demonstrating the management of risks by relevant parties to the intercompany loan.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements)a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

Not yet, but legislation is expected soon, that will address hybrid mismatch arrangements.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Under Israel's the CFC regime, an Israeli company or individual may be taxed on a proportion of certain *undistributed profits* of certain Israeli-controlled, non-resident companies in which the Israeli shareholder has a controlling interest (10% or more of any of the CFC's "means of control"). A CFC is a company to which a number of cumulative conditions apply, including that most of its income or profits in the tax year were derived from passive sources (e.g. capital gains, interest, rents, dividends, royalties) and this passive income has been subject to an effective tax rate that does not exceed 15%.

In such a case, the Israeli shareholder controlling the CFC will be treated as if he had received its proportionate share of the profits as dividends (deemed dividends). Upon the distribution of profits, the Israeli controlling shareholder will be eligible for a deduction in the amount of the gross national dividends that were subject to Israeli tax (however, the deduction will not exceed the amount of profits being distributed), in addition to a tax credit for the foreign tax paid.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

No specific rules about guarantees, except for the fact that in TP audits (in practice) the ITA will request an explanation about the pricing and compensation of guarantees (if they exist) or sometimes may ask questions about the lack of a guarantee on a specific transaction.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

With respect to thin capitalization rules, Israel has no statutory or regulatory provisions or other rules for tax purposes as exist in certain other jurisdictions. Since there are no thin capitalization rules and Israel has no specific debt-to-equity ratio requirements, an Israeli company may be financed with minimum capital, and there is no limit to the amount of debt that may be used.

As there are no thin capitalization rules in Israel, this allows Israeli borrowers in controlled loan transactions to be highly leveraged, which results in high interest payments that will be deductible for tax purposes in Israel. We expect that for this reason controlled intercompany loans will be subject to increased scrutiny by the ITA. Additionally, it is expected that this issue will be resolved when Israel implements the recommendation prescribed under BEPS Action #4 and limits the interest payment amount deductible for income tax by applying a Fixed Ratio (= borrower's net deduction for interest/EBITA ~ 10%-30%) and/or a Group Ratio (= Group's net deduction for interest/EBITA).

Yariv Ben-Dov is a partner at Herzog Fox & Neeman, Tel Aviv, Israel and the head of the firm's transfer pricing practice. He may be contacted at:

bendovy@hfn.co.il

http://www.hfn.co.il/

NOTES

[1] Financial arrangements include, inter alia, senior/ subordinated short & long term loans, advances, capital notes, loan guarantees, receivables factoring, cash pooling and deposits.

Italy

Aurelio Massimiano, Marco Valdonio, and Mirko Severi
Maisto e Associati

Introduction

The Italian transfer pricing legislation is governed by Article 110(7) of the Consolidated Tax Act (CTA) recently amended by Article 59 of Law Decree No. 50/2017.

While the previous rules make reference to the so-called "normal value" for determining the price for intercompany cross-border transactions, the new rules now generally refer to the "conditions and prices that would have been agreed between independent parties acting on an arm's-length basis and in comparable circumstances." The new rules also indicate that the Ministry of Finance will issue an implementing decree in order to set forth guidelines for the new principle, taking into account international best practices. Although in 2013 the Italian Ministry of Finance had already issued an authorized translation of the 2010 OECD TPG into Italian, thus implying a domestic endorsement of their contents, the implementing decree will probably represent a valuable tool to foster a full alignment of Italian TP practice with the OECD standards.

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

This issue has been addressed by the Italian tax authorities only marginally. Indeed, Circular No. 32/9/2267, dated September 22, 1980, is mainly focused on the identification of the relevant market for the identification of comparables.

However, in our experience, the arm's-length character of interest rates is mainly determined by the Italian tax authorities applying the external comparable uncontrolled price (CUP) method. The application of this method can follow two different approaches. Under the first approach, the Italian tax authorities make reference to the average interest rates on similar loans provided by the official bulletins of the Central Bank of the lender's country. The weakness of this approach derives from the circumstance that the data of the Central Bank bulletin refers to bank loans and it could be not an appropriate CUP when the lender is not a financial entity. Under the second approach, an arm's-length interest rate may be determined as follows:

(i) First, the credit rating of the debtor is determined on the basis of financial and non-financial information (e.g., using Moody's database).

(ii) Second, the appropriate spread is determined on the basis of the credit rating obtained above (i.e., at the time of granting the loan), looking at the rate applied in publicly traded financing transactions to borrowers (or bond issuances) with a similar rating. This credit spread (generally applied on a reference rate such as Euribor) corresponds to spreads charged by third parties on loans to debtors with similar credit ratings.

(iii) Finally, the interest rate determined above may be adjusted on the basis of the specific terms and conditions of the intra-group loan (e.g. maturity, currency, subordination, etc.).

In some instances, historic or existing external bank financing may be also used by a taxpayer as an internal CUP.

There are few cases where the Italian tax courts have addressed the methods for evaluating an arm's-length interest rate on related-party loans. For example, decision No. 253, dated November 15, 2002, of the Provincial Tax Court of Ravenna involved an Italian company that funded a foreign subsidiary interest-free. The Provincial Tax Court confirmed the approach of the tax authorities, according to which the Italian company should charge the foreign subsidiary interest at a rate determined on the basis of an external CUP using the statistical data collected by the Italian Association of Banks.

In the decision of the Supreme Court No. 22010, dated September 25, 2013, endorsed the use of the official bulletins of the Central Bank of the lender's country as a benchmark in applying the external CUP.

There are also cases where the Italian tax courts came to the opposite conclusion. Indeed, decision No. 2725, dated June 18, 2015, of the Regional Court of Lombardy cancelled the transfer pricing adjustments claimed by the Italian tax authorities based on the official bulletins of the Bundesbank as a reference for determining the interest rate in a loan between an Italian company and its German parent company. Indeed, according to the tax court, the bulletins should not be considered as a reliable benchmark.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

No. In our experience the Italian tax authorities do not express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's- length basis. How are these issues dealt with in your country?

As mentioned above, in our experience, the arm's-length of interest rates is mainly determined by the Italian tax authorities applying the CUP method. Assuming that there is no internal CUP, the following steps are generally followed to identify an external benchmark: a) *Identification of the relevant market:* the 1980 Circular is focused on the identification of the relevant market for the selection of comparables and it states that in determining the arm's-length value of interest, reference should be made to the current interest rate prevailing in the lender's country of residence. The position was based on the assumption that in general the borrower is the one that seeks a loan in the market of the lender and, normally, the conditions of a loan do not change depending on the location of the borrower. In addition, the 1980 Circular lists some factors that should be taken into account in determining the arm's-length interest rate that include, among others, the "financial situation of the borrower" and the "guarantee given for the loan."

Even if the position expressed in the Circular is quite dated and is based on a static concept of capital markets that surely no longer applies today (where borrowers could gather financing from wherever in the world), tax authorities tend to stick to that approach even if it is now in contrast with the OECD guidelines.

However, the 1980 Circular also provides that the "criterion of the lender" must be interpreted and applied in a flexible way, taking into consideration the market where the borrower obtained the funds. In affirming the substantial approach the 1980 Circular provides some examples in which the arm's-length interest rate should differ from the prevailing interest rate in the country of the lender. In particular, the 1980 Circular highlights the following cases:

- a lender that obtains funds from a low tax jurisdiction;
- a lender that obtains the funds in the same country in which the borrower is resident; and
- a lender that obtains the funds at special conditions (i.e. incentives for granting international loans).

The second step is the identification of comparable transactions. To find comparable external transactions companies usually run a search using a database to identify corporate bonds having similar characteristics to the intragroup loan. To this end, the 1980 Circular expressly states that the following factors should be considered in determining the arm's-length interest: amount; duration; object of the loan agreement; financial conditions of the borrower; currency; exchange risks and guaranties.

In order to correctly reflect the arm's-length interest rate applicable to the tested transaction, a number of adjustments may be applied, e.g. maturity adjustment; liquidity adjustment and credit rating adjustment.

As a matter of practice, however, it is noted that in several cases (in particular, when the transaction has a negligible amount) taxpayers and tax authorities refer to the official bulletins issued by the Italian Central Bank.

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

The Italian tax authorities do not apply the "bona fides" principle created by the US courts in tax cases. However, in accordance with the OECD TPG, the Italian tax Authorities usually follow a "substance-over-form" approach, verifying whether the contractual terms are consistent with the functional analysis and with the actual conduct of the parties to the transaction. In cases where the contractual terms are not aligned with the actual behavior of the parties, the Italian tax authorities tend to recharacterize their interpretation of the domestic transfer pricing provision in the light of the non-recognition provision included in the OECD TPG.

In that regard, Circular No. 6 of March 30, 2016, specifically concerns the application of the non-recognition provision to disregard a loan arrangement and recharacterize the loan for tax purposes as an equity investment, whereupon the interest would not be deductible. According to the circular, the non-recognition may occur when a case-by-case analysis conducted by the Italian tax authorities, based on factual circumstances and objective indicators, demonstrates that: (i) the repayment of the shareholder loan is subordinated to the repayment of third party loans; and/or (ii) the financial covenants do not include the shareholder loan within the definition of debt; and/or (iii) the repayment of the shareholder loan (or the payment of interest thereon) is subject to the same restrictions provided to the payments of dividends and of equity.

It has been observed that during tax audits, the Italian tax authorities have also recharacterized intercompany transactions on the basis of the domestic provision relevant to the abuse of law, even though the provision is not specifically designed to target transfer pricing issues. According to Art. 10-*bis* of the Law No. 212 of July 27, 2000, there is "abuse of law" when one or more transactions, despite being formally compliant with the tax rules, (i) lack any economic substance, and (ii) are mainly aimed at obtaining undue tax advantages. In particular, transactions are deemed to lack of economic substance when facts, actions and agreements, even when related to each other, are unable to generate significant business consequences other than tax advantages. In this regard, Article 10-*bis* makes reference to cases where there is an inconsistency between the qualification of the individual transactions and their legal basis as a whole, and where the choice to use certain legal instruments is inconsistent with the ordinary market practice.

This approach was also recently endorsed by Italian case law. In this regard, for instance, reference can be made to the judgment of the Supreme Court No. 7493 of April 15, 2016, dealing with the application of the transfer pricing rules to non-interest-bearing loans. In particular, the Court ruled that in order to determine the arm's-length nature of a transaction, it is necessary to examine the economic substance of the transaction, irrespective of any obligation eventually negotiated by the parties relevant to the payment of consideration.

Finally, it should be mentioned that according to a principle codified in the Civil Code, claims on sums of money bear interest by operation of law, unless the law or the instrument or transaction provides otherwise (Art. 1282(1) of the Civil Code). Art. 1284 of the Civil Code provides that the interest rate agreed by the parties must be specified in writing; otherwise, interest is due at the legal rate. The Civil Code (Art. 1815) expressly provides that the presumption of legal interest also applies to loans. Tax courts have confirmed the applicability of this presumption of interest in the absence of a written agreement with a legally certain date that confirms the loan is interest-free.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

During tax audits concerning the alleged violation of Italian transfer pricing rules with respect to interest arising from intercompany financing, Italian tax authorities have become more sensitive to the level of "implicit" group financial support for the borrower. Nevertheless the only clarification made by the Italian tax authorities in that regard dates to chapter IV of the 1980 Circular. This chapter is wholly dedicated to the subject of arm's-length interest. In particular, the Italian tax authorities provided that in determining the arm's-length interest, one should take into account, among other things, the financial situation of the borrower and the guarantee given for the loan. This provision was not introduced to address the concept of "implicit" group financial support. However, in our view, it is reasonable that the expression "guarantee" was in principle sufficiently broad to include the "implicit" support. This view is even more significant for banks and financial institutions because the regulatory system for banks is consistent with that approach. Indeed, generally the whole of the bank's assets and capital are potentially available to meet any claims on the bank regardless of where the liability leading to the claim is located. Therefore, the subsidiary normally shares the same creditworthiness as the enterprise of which it is a part.

With regard instead to other business sectors, a case-by-case analysis is needed in order to assess which form of credit rating- the stand-alone or the group consolidated credit rating is appropriate when measuring the credit worthiness of an entity.

- If the parent company's credit profile is stronger than the subsidiary, the legal, operational and strategic ties between the two entities should be taken into consideration to measure the willingness and ability of the parent company to provide support. These elements serve to assess both the level of implicit support that the parent would provide its subsidiary in case of default, as well as the level of correlation between the businesses of the parent and the subsidiary. Indeed, the stronger the correlation, the less probable it is for the parent to survive in the event of the default of its subsidiary. Thus the higher the level of correlation between the businesses, the lower the benefit provided to the subsidiary and, thus, the value of the guarantee.
- If the subsidiary's stand-alone credit profile is stronger than the parent's stand-alone credit profile, then irrespective of the legal, operational and strategic ties that measure the willingness and ability to provide support, it is unlikely that a parental guarantee provides significant benefit to the subsidiary.
- If the parent and the subsidiary's stand-alone creditworthiness are the same, there could nonetheless be a benefit to the guarantee. The subsidiary may benefit from the guarantee due to its option to rely on its parent to step in if it were to default. This depends, however, on the ability of the parent to provide support and on the correlation between the businesses.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

As mentioned above the starting point to determine the risk profile of the borrower will often be an assessment of its stand-alone rating. Once a stand-alone rating has been determined, some further refinement can be performed. The most important refinement is determining the probability that a parent company would intervene if a subsidiary were to face going into default. Other factors that might influence an adjustment of the rating include collateral and the type of loan.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Interest rates are typically set on the basis of the CUP method. Because internal CUPs will in most cases not be available, given the lack of comparability, external CUPs are used most often to support an interest rate. Various tools and databases are available to find comparable external transactions to benchmark intra-group loans. Both loan data as well as bond data can be used. Pricing of specific options or conditions is typically done by targeting higher or lower in the range, unless a specific pricing can be sufficiently substantiated.

However, as already mentioned, the Italian tax authorities do not own a reference database for financial transactions and, therefore, usually make refer to the average interest rates on similar loans provided by the official bulletins of the Central Bank of the lender's country. Finally, it should be noted that bank quotes are typically not accepted by the Italian tax authorities because they do not represent an actual "transaction."

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The Italian transfer pricing rules do not provide for a safe harbor on interest rates.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

We are not aware of any disputes concerning negative interest rates. Having clarified that, we believe that the application of a negative interest rate in an intercompany transaction could hardly be supported. Indeed, it is hard to rationalize that a company belonging to a multinational group that lends its funds to a related-party should also pay for doing so unless it can be demonstrated that the only alternative for the company would have been to maintain excess cash in its bank account and pay interest thereon. Even if there were circumstances where financial institutions would need to use negative rates, it should be considered that these entities have a different business strategy and other means to recover costs (i.e., through fees or other business segments).

However, it should be considered that generally, the spread applied to the floating (negative) base rate may be sufficient to ensure the overall interest rate is positive. This may therefore alleviate the risk related to any possible assessment on an intercompany loan with a negative interest rate. In addition to these factors, consideration should also be given to the opportunity cost for the lender. The lender could, for example, use the funds for other investing opportunities that would likely yield a higher return than a negative interest rate.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

One important issue in Italy is the treatment of interest-free loans from the perspective of both the tax authorities and the Supreme Court. Indeed, the Italian tax authorities take the position that transfer pricing rules are applicable to both interest-bearing and interest-free loans. On the other hand, the views of the Supreme Court on this matter seem to be quite inconsistent. For example, the Supreme Court issued an interesting interpretation with regard to the application of transfer pricing rules to a cross-border interest-free loan advanced by an Italian parent company to its wholly owned subsidiary in France. Decision No. 15005, dated July 17, 2015, of the Supreme Court began its reasoning by referring to the domestic transfer pricing provisions for the year at issue in Articles 110 and 9 of Presidential Decree 917 of December 22, 1986. According to domestic transfer pricing rules, items of income arising from transactions with non-resident associated enterprises were determined based on the "normal value" of the goods sold, services rendered and goods or services received. The "normal value" was defined as the "price or consideration" applied on average for goods or services of the same kind or similar, in free competition conditions and at the same market level, in the time and place where goods and services are purchased or rendered or, lacking that, in the nearest time and place.

In the view of the Court, the "normal value" stipulated by domestic transfer pricing rules should be interpreted consistent with the arm's- length principle in light of the OECD TPG. After the preamble, the Court looked at the object and purpose of transfer pricing rules and maintained that the purpose of transfer pricing rules is twofold.

On the one hand, the Court stated that transfer pricing rules allocate taxing powers between tax jurisdictions with respect to certain transactions having cross-border features. Under this perspective, transfer pricing rules confer to the contracting states the ability to tax certain profits,that would have accrued if the associated enterprises, resident in the two contracting states, had regulated their commercial or financial relations on the basis of conditions that would have existed between independent enterprises. On the other hand, the Court maintained that transfer pricing rules also have an anti-avoidance purpose. In particular, the rules grant tax authorities the power to adjust the prices applied in economic or business transactions between associated/controlled entities that are resident in several jurisdictions, with the aim of preventing artificial adjustments to those prices, that are made for the purpose of optimizing the tax burden of the group, for instance, by shifting the income towards companies established in territories or jurisdiction characterized by a lower taxation. thus, on these grounds, with regard to the first purpose of transfer pricing rules (i.e., allocation of taxing powers), the Court took a very formalistic approach and held that the application of the transfer pricing rule is subject to two conditions: (i) that from the intra-group transaction the taxpayer derives (positive or negative) items of income; and (ii) the application of the normal value criterion causes an increase in the taxable income. Hence, in the case of interest-free loans, those conditions are not fulfilled, as under such an agreement there is an absence of any price or consideration necessarily comparable with the "normal value."

As regards the second purpose of transfer pricing rules, in examining the case from an anti-avoidance perspective, the Court maintained that the tax authorities did not prove either the shifting of income towards low-tax jurisdictions or the absence of valid economic reasons, and that, instead, the taxpayer had shown that the loan had the purpose to finance the French subsidiary for the acquisition of a participation in another French company.

In conclusion, based on the above grounds, the Court ruled in favor of the taxpayer and maintained that the interest-free loan was not subject to transfer pricing rules.

In any case, the decision of the Supreme Court must not be regarded as the final position of the Italian jurisprudence on the matter. Indeed, the principles upheld in the decision in comment were reversed in the decision of the same Supreme Court of April 15, 2016, No. 7493. In the latter decision, the Court held that interest-free loans are subject to transfer pricing rules and interest income must be determined based on the arm's-length principle. In particular, the Supreme Court stated that the application of transfer pricing rules to interest-free loans should not be neglected based solely on the arising of taxable income, but analyzed in connection with the loan's economic substance, and compared to similar transactions.

The above conclusion has been also confirmed by Decision No. 3773, dated September 26, 2017.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

As far as the implementation of BEPS Action 2 is concerned, Italy already has a defensive rule in force for tackling hybrid financial instruments. This rule was introduced in 2004 and thus well before the BEPS actions were released. Pursuant to this provision: "[p]articipation in the capital or equity, as well as securities and financial instruments [. . .] issued by companies and institutions mentioned in Article 73, paragraph 1, letter d (i.e. non-resident persons) are considered similar to shares on the condition that the related remuneration is fully not deductible for the non-resident issuer in determining the taxable income in the foreign country of residence; for this purpose the non-deductibility must result from a statement by the issuer itself or by other certain and reliable elements of proof [. . .]"

Therefore, a payment made under one of these instruments is not treated as a dividend at the level of the recipient resident taxpayer if the distributing company can fully or partially deduct the amount in its state of residence. The rule was recently supplemented to implement the Directive of July 8, 2014 No. 2014/86/EU, amending the Parent–Subsidiary Directive (of November 30, 2011, No. 2011/96/EU).

Article 14 of the legislative decree of September 14, 2015, No. 147, introduced – in accordance with BEPS Action 2 – the so-called branch exemption regime into Italian tax law. According to this provision, an optional branch income exemption regime is now available as an alternative to the ordinary imputation regime.

There is already a robust set of rules in place domestically that seem to be broadly in line with the BEPS outcomes for both controlled foreign companies (CFCs) and interest deductibility.

Finally it should be noted that the implementation of the full set of rules on hybrid mismatch arrangements will also depend on the EU's action in this respect.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

In Ruling No. 44/E of March 20, 2006, on capital endowment attributable to the PEs of non-resident companies, the Italian tax authorities affirmed that the amount of a PE's deductible interest expenses must be consistent with the loans that would have been raised *"if the permanent establishment could have disposed of an adequate endowment fund,"* and does not necessarily need to correspond with the one arising from the accounting results.

The Ruling begins its analysis by considering that, in order to reach an arm's-length attribution of taxable profits to a PE, it is necessary to ensure that:

(i) the PE is treated as a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions; and, therefore

(ii) the PE has an appropriate amount of capital to support the functions it performs, the assets it uses and the risks it assumes.

To this extent, the Circular refers to that kind of capital which does not give rise to a tax-deductible financial charge under the rules of the host country, i.e., the "free capital."

Following the publication of Ruling No. 44/E of March 20, 2006, the Italian tax authorities have focused their attention on this issue and carried out a number of tax audits. The approach usually applied by tax authorities is the Regulatory Minimum Capital Approach (RMCA); in particular, the auditors attribute to the Branch the same minimum amount of capital that the Italian banking regulator (i.e., *Banca d'Italia*) would set for an independent banking enterprise or a comparable non-EU bank's PE operating in Italy.

However, it should be noted that Article 7 of Legislative Decree No. 147 of September 14, 2015, has introduced several changes with respect to the taxation of non-resident taxpayers. In particular, the amendments to Article 152 CTA have introduced new provisions for the attribution of profits to permanent establishments, in line with the principles set forth in

Article 7 of the OECD Model and with the Authorized OECD Approach (AOA).[1]

In that regard, the amended Article 152(1) CTA has completely abolished the partial "force of attraction" principle enshrined in the former wording, providing that income attributable to the permanent establishment comprises gains and losses pertaining to it only. Moreover, the new provisions of Article 152(2) CTA clarify that the permanent establishment is to be considered as a separate and independent entity for tax purposes, taking into account the functions performed, the asset used, the risks assumed and the appropriate level of free capital. Finally, Article 152(3) CTA, explicitly referring to Article 110(7) CTA, provides for internal dealings to be priced at arm's-length.

Following the amendment of Article 152 CTA, the Director of the Revenue Agency published Decision No. 2016/49121 of April 5, 2016, confirming that the main approaches for the attribution of profits to permanent establishments are the Capital Allocation Approach (to be applied only if the country of the parent company allows the exchange of information) and the Thin Capitalization Approach. Instead, the Quasi-Thin Capitalization approach should be considered as a safe harbour. This method determines the branch capital by directly applying the regulatory capital requirements to the branch as if it were a local independent bank owning the same assets. Usually this method has been applied based on the specific regulation set forth by Bank of Italy on "Large Exposures" (Chapter IV, Section V of the Supervisory Instructions for banks Letter no. 229/1999), which is not applicable to branches of foreign banks.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

The Italian tax authorities have not published guidance on explicit loan guarantees. However, based on our experience, before determining the (possible) intercompany fee to be paid for a parent company loan guarantee, the first step of the analysis is the so-called "benefit test." The outside lender's rationale for requesting a parent guarantee may include several concerns: first, the parent may have more substantial assets or operations from which to look for repayment than the subsidiary; second, it is the parent that may effectively control the assets, operations, and profitability of the subsidiary.

The lender's first concern is quite relevant to application of the arm's-length standard. To the extent the parent puts its more substantial assets and better credit rating at risk by guaranteeing its subsidiary's borrowing, the guarantee enhances the subsidiary's commercial position relative to a similarly situated independent competitor. The parent rightly should receive a guarantee fee for providing this benefit to the subsidiary. The lender's second concern arguably is not pertinent to the arm's-length inquiry. To the extent the guarantee merely reassures the lender that the parent will not use its control over the subsidiary in a way that leads to default on the loan, the guarantee does not actually enhance the subsidiary's commercial position. Rather, it addresses the "moral hazard" risk inherent in the control relationship between the parent and subsidiary. For an independent competitor otherwise similarly situated to the subsidiary, the lender might not require an outside guarantee because no comparable moral hazard exists. In this circumstance, it is in our opinion fully consistent with the arm's-length standard to ignore the parent company guarantee and not require or impute an intercompany guarantee fee.

Please note that the Italian tax authorities usually do not apply the benefit test in cases where the guarantor company is Italian.

After applying the benefit test, the appropriate charge for a guarantee is determined often based on different approaches:

- the benefit approach: this method estimates the guarantee fee based on the saving due to credit enhancement from guarantee.
- a method based on Credit Default Swap (CDS) transactions. Credit default swap (CDS) benchmarking establishes an arm's-length range for a guarantee fee by reference to available market data on CDSs, making adjustments as necessary to reflect economic conditions and the scope, terms, and conditions of the specific nature of the guarantee provided; or
- the actuarial method (also known as the Insurance method or expected loss methodology). The objective of this method is to replicate the market outcome to price the transaction. The pricing model based on the Actuarial Method has three major components: cost attributable to the expected loss; cost attributable to administrative expenses; and the opportunity cost of capital;

Based on our experience, the Italian tax authorities do not have a uniform approach on the method to be apply. In fact, different local offices often apply different methods to determine the guarantee fee.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Under Italian tax law, interest expenses are deductible up to an amount equal to interest income accrued in the same fiscal year. Any excess over that amount is deductible up to 30% of the gross operating income derived through the core business of the company. The gross operating income (earnings before interest, taxes, depreciation and amortization, EBITDA) is calculated as the difference between (i) the value of production and (ii) costs of production, excluding depreciation, amortization and financial leasing installments relating to business assets as well as capital gains or losses upon transfer of going concerns. As of January 1, 2016, for taxpayers whose fiscal year coincides with the calendar year, the gross operating income also includes dividends received from non-resident subsidiaries in which the Italian resident company holds more than 50% of the votes that may be exercised in the ordinary shareholders' meeting of the subsidiary. The possibility of increasing the 30% of EBITDA by the amount of dividends received from non-resident subsidiaries was repealed retroactively by Finance Act 2018, effective as of the fiscal year following the fiscal year current on December 31, 2016 (i.e., as of January 1, 2017, for taxpayers whose fiscal year coincides with the calendar year). This change was aimed at aligning the domestic regime on the limitation on interest deduction with Article 4 of the ATA Directive (Council Directive (EU) 2016/1164 of July 12, 2016). Thus, today no group ratio can be considered applicable.

Any excess of interest expenses over the above threshold (i.e., 30% of EBITDA) may be carried forward without time limitation and can be deducted in the following fiscal years to the extent that the net interest expenses (i.e., those exceeding interest income) accrued in the following years are less than 30% of EBITDA. If, in a fiscal year, there is an excess of 30% of the EBITDA over the net interest expenses, such excess may be carried forward without limitation and may be used to increase the relevant threshold in the following fiscal years (Article 96 of the CTA).

The limitation to the deduction of interest, i.e., the EBITDA rule, applies to interest, other than capitalized interest, that is derived from any transaction having a financial purpose, including loans (irrespective of whether they are related to loans granted or guaranteed by related parties), bond issues and financial leasing transactions (as far as the implicit interest component of the leasing installment is concerned).

Interest that is not deductible under the EBITDA rule is not recharacterized as a dividend distribution in the hands of the recipient. Therefore, interest payments remain fully taxable in the hands of the recipient, even when they are not deductible from the taxable income of the borrowing company (Article 96 of the CTA).

Aurelio Massimiano and Marco Valdonio are Partners at Maisto e Associati. Mirko Severi is Associate at Maisto e Associati. They may be contacted at:

a.massimiano@maisto.it

m.valdonio@maisto.it

m.severi@maisto.it

http://www.maisto.it

NOTES

[1] Cf. OECD, *Report on the attribution of profits to permanent establishments* (July 2010).

Japan

Takuma Mimura
Cosmos International Management Co., Ltd.

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

In Japan, Article 66-4 of the Act on Special Measures concerning Taxation ("ASMT") is a base law of transfer pricing taxation, but the law itself does not specify how to evaluate an arm's length rate on related party loans. Instead, the National Tax Agency ("NTA") provides Circulars as internal guidance for its tax examiners, and the Circular related to ASMT ("ASMT Circular"), Article 66-4 (7)-4, provides guidance on related party loans. The following is an excerpt from the ASMT Circular:

Treatment of loan or borrowing of money

Article 66-4 (7)-4: In the case of applying the method equivalent to the comparable uncontrolled price method or the method equivalent to the cost plus method for monetary loan/borrowing transactions, the currency pertaining to the comparable transactions should be the same with the currency pertaining to the foreign related transaction, and various factors affecting the interest rate such as borrowing date, borrowing period, the methods of interest rate (fixed or variable, single interest or compound interest, etc.), the interest payment method (pay in advance or in arrears), the creditworthiness of the borrower, existence of collateral and guarantee, and so on should be similar between the comparable transactions and the foreign related transaction.

(Note) Method to calculate an arm's length interest rate that would be applied as if borrowers in the foreign related transaction would have borrowed from banks etc. under the similar conditions as the relevant foreign related transactions, will be a method equivalent to a method consistent with the comparable uncontrolled price method.

The Circular thus approves the use of methods equivalent to CUP and Cost Plus methods. It also indicates that under the method equivalent to the method consistent with CUP method, the deemed borrowing rate by the borrower of the foreign related transactions from financial institutions (even if not actually borrowed) can be used as comparable interest rates. There is, however, no guidance on the method equivalent to the Cost Plus method.

In addition to the general rule stated above in the ASMT Circular- for related party loan transactions by companies not doing financial service business- a method equivalent to a method consistent with the CUP method is allowed as a simplified method in calculating arm's length loan interest rates. This method is described in the following article in the Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines) issued by the NTA ("TP Directive").

Consideration to apply a method equivalent to a method consistent with the CUP method for lending and borrowing activities

Article 3-7. In conducting examinations on lending and borrowing activities between a corporation and a foreign-related person, in cases where neither party is engaged in lending or investment activities as a business, an application of a method equivalent to the method consistent with the comparable uncontrolled price method using the following interest rate as the arm's length interest rate shall be considered where necessary:

(1) The interest rate that would normally be applied to a loan, assuming that the borrower involved in the foreign-related transaction made the loan from an unrelated bank under similar conditions in terms of currency, borrowing date, and borrowing period.

(2) The interest rate that would normally be applied to a loan, assuming that the lender involved in the foreign-related transaction made the loan from an unrelated bank under similar conditions in terms of currency, borrowing date, and borrowing period.

(3) The interest rate that would normally be earned on the funds involved in the foreign-related transaction, assuming that they were invested in government securities or the like under similar conditions in terms of currency, transaction date, and transaction period (exclusive of cases where the interest rate set forth in (1) is applicable).

Note

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1. For the above three methods, the order (1), (2), (3) coincides with the preferred order of the methodology to be able to obtain arm's length result.

2. In cases where the interest rate set forth in (2) is applicable, and the loan actually made from a bank and so on to the lender in the foreign-related transaction is a loan made under similarconditions as set forth in (2), whether the loan has a conditional relationship with the foreign-related transaction is of no relevance.

In summary, although Japanese transfer pricing law does not specify the applicable transfer pricing methods for related party loans, it is understood from the NTA's internal guidance that generally the method equivalent to the CUP method and the Cost Plus method are applied. Especially with regard to related party loans by non-financial service industry lenders, a less strict method called "the method equivalent to *the method consistent with* CUP method" is applied. Thus the NTA and its regional tax bureaus ("tax authorities") usually apply, in the order (1) to (3), the NTA's internal guidance TP Directive 3-7 to related party loans by non-financial industry lenders.

In applying Directive 3-7 (1) and (2), even if there's no actual comparable borrowing by the related party borrower (for (1)) or the related party lender (for (2)) from unrelated banks, the tax authorities can apply the deemed borrowing rate that the borrower or the lender would have borrowed in similar terms and conditions from market. Recently, interbank offered rates such as TIBOR (for Japanese Yen as "JPY") or LIBOR (for USD) for short term loans, or fixed swap rates for long term loans, are used for base rates, and the tax authorities tend to apply an "appropriate" comparable spread. In the past, the typical spread was 0.5%, but recently, especially for JPY-currency borrowing, because of extremely low JPY interest rates and fierce competition among Japanese banks, JPY spreads in the market has been sharply reduced even for smaller sized and less credit worthy borrowers.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

There's no official announcement regarding different treatment with regard to valuation methods or approaches between outbound and inbound related party loans, therefore, the above Circular and Directive should, in principle, be applied equally to both outbound and inbound related party loans.

Although there has been no actual evidence for a difference in practice, such as announcements of litigation or tax adjustments, one might guess that the tax authorities usually would like to apply the highest possible interest rates for outbound related party loans, and the lowest possible interest rates for inbound related party loans, except when the inbound borrower has negative taxable income and only withholding tax on the payment of interest can be levied. It is, however, difficult to find actual examples of different enforcement between outbound and inbound loans, such as taking an implicit support factor into consideration for determining arm's length interest rates to be lower only in inbound related party loans.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

Transfer pricing regulations and its enforcement in Japan are based on the arm's length principle, and examinations are made to evaluate whether independent parties perform similar transactions on standalone basis. In that regard, if a loan is made to a Japanese entity from overseas affiliates, but there's no loan agreement or there are no terms stated in the agreement, the tax authorities might regard the loan as equity and deny deductibility of interest payments or accruals.

In addition, as already mentioned, there is no official rule about, and it does not seem that the Japanese tax authorities consider, the overseas affiliate's implicit support for evaluating lower interest rates on inbound related party loans.

There are no safe harbor rates or suggested margins (spreads) announced officially or unofficially. Japanese transfer pricing enforcement is based on the OECD Transfer Pricing Guidelines, and the arm's length principle is always preferred and respected.

If a foreign corporation provides loans to a Japanese affiliate and TP Directive 3-7 (1) and (2) cannot be applied, then Directive 3-7(3) could be applied as a last resort. According to Directive 3-7 (3), the yield on government bonds that have the similar terms and conditions will be used. If the loan is denominated in JPY, the issue is then how the Japanese Government's current negative yields for up-to-ten-year bonds should be used. No news has been heard about whether in such a case the tax authorities have claimed any payment of negative interest from the foreign lender to the domestic borrower.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

There has not been any changes on the tax regulations made in connection to BEPS Action 2. This is partly because Japan's tax regulations basically have not allowed such hybrid mismatch arrangements to be in place.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Japan introduced the "distinct and separate enterprise" approach for calculating a PE's income for financial years beginning from April 1, 2016. Therefore, now the internal payment of interest from a Japanese PE to its foreign head office is tax deductible under certain conditions. Examples of these are:

(1) To make allocations of income or expense of external transactions to the PE or to make internal transactions paid from the PE to the same legal entity's head office tax deductible, a taxpayer having the PE has to prepare documentation including verifications of the transactions involving the PE, details of assets and liabilities used for the transactions, and functional analyses like those that are stated in the transfer pricing documentation.

(2) Because there exists no share capital at a PE, an amount of deemed capital attributable to that PE is calculated. And if the amount of branch capital recorded by the PE is less than the amount of the deemed capital, the amount of interest paid for that portion of the capital (i.e., recorded capital minus the deemed capital) is non-deductible.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

While there is no formal rule for calculating the prices or rates of related party guarantee in Japan, it is said that tax examiners like to use a method that first calculates the benefit of the guarantee margin (i.e., the difference between the interest rate without the guarantee and the rate with the guarantee), and allocates half of that margin as the guarantee fee to be charged to the borrower. For example, if a foreign subsidiary having a BBB credit rating receives a loan subject to a guarantee from a Japanese parent company having a single A credit rating, and the interest rate to a single A borrower is 0.2% lower than the interest rate to a BBB borrower, the tax authorities may insist that 0.2%/2, or 0.1% should be charged as a guarantee fee from the Japanese parent company to the foreign subsidiary. However, for loans denominated in JPY, interest rates are currently very low and such a difference would be below 0.1%, maybe giving less incentive for the tax authorities to claim a guarantee fee.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

In Japan, other than transfer pricing regulations, which require interest rates to be based on the arm's length principle, there are two kinds of limitations on deductions for related party loan interest. One limit is the traditional thin capitalization rule, and the other is an earnings stripping rule which became effective for fiscal years beginning on or after 1 April 2013. While the thin capitalization limitation on interest is balance-sheet based (interest expense on debt exceeding three times equity), the earnings stripping limitation is based on a company's profit and loss statement, generally net related party interest expense exceeding 50% of adjusted income.

If both the thin capitalization and the earnings stripping rules result in disallowed interest, the rule that denies the higher amount of interest in that year applies.

It may be that the two rules on the limitation of a related party's interest deduction may result in less strict transfer pricing enforcement on related party inbound loans. It should be noted, however, that transfer pricing enforcement is still likely to be made on inbound related party loans, even if the related party loan does not exceed the thresholds of both the thin capitalization and earnings stripping rules.

Takuma Mimura is a managing director of Cosmos International Management Co., Ltd., which belongs to Nagoya-based accounting firm Cosmos Group. Cosmos International Management is also an Alliance Partner of Transfer Pricing Associates group. Takuma may be contacted by email at:

tmimura@cosmos-international.co.jphttp

www.cosmos-international.co.jp/english/index.html

Korea

Tae Hyung Kim and Seung Kwon Song
Deloitte, Korea

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

In general, the arm's length interest rate is analyzed based on an internal or external CUP method (i.e., an analysis of interest rates applied between 3rd parties). Based on our past experience, disputes between the tax authorities and taxpayers about the arm's length nature of interest rates have primarily centered around the necessity of adjustments for differences between the related-party loan and third-party loans, the availability of reliable third-party information for purposes of the adjustments, and the reliability of the performed adjustments.

Article 6-7 of the Presidential Decree (PD) of the Law for the Coordination of International Tax Affairs (LCITA) specifies that the arm's length interest rate must be calculated by taking into consideration the following elements: the amount of a loan, the maturity of a loan, the security of a loan, and the credit rating of a borrower.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

As far as the authors know, valuation methods and approaches are not treated differently for domestic borrowers in international transactions than for domestic lenders in international transactions. However, the following point is worth noting. When the CUP method is applied, the tax authorities tend to focus on domestic interest rate comparables in the investigation of inbound transactions as opposed to foreign interest rate comparables that are the primary focus of the tax authorities in the case of outbound transactions.

In the safe harbor rule, however, different rates are applied to outbound transactions (domestic lender/foreign borrower) and inbound transactions (foreign lender/domestic borrower), respectively. For more information on inbound and outbound rates under the safe harbor rule, see the response to question 3, part e.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

An intercompany agreement is a critical component that the tax authorities generally request and look at when evaluating and determining the arm's length nature of a financial transaction (e.g., an advance or a loan). In general, the tax authorities regard the existence of an agreement entered into prior to the financial transaction as important evidence in establishing the financial transaction's bona fides. When an agreement does not exist, the tax authorities look at the transaction in context when evaluating whether the transaction is a borrowing or an equity infusion in nature, taking into consideration the length of the collection or payment period of receivables or payables as well. Once the tax authorities determine that an intercompany loan is made, the arm's length interest rate is analyzed.

There is a tax ruling case involving an interest-free component of a loan. A petroleum development company provided a loan to a foreign affiliate engaged in exploration of petroleum on a contingent basis, that is, no interest was charged until the successful completion of exploration. For this case, it was ruled that the zero rate was arm's length.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

The LCITA does not provide any guidance on how to treat passive association or implicit support in the evaluation of the arm's length nature of an intercompany transaction. The authors' expectation, based on experience, is that the National Tax Service (NTS) will move in line with the OECD Transfer Pricing Guidelines, which suggest that the borrower should be evaluated as a member of a multinational group benefiting from association with its group, as long as the benefit is incidental to group membership and is not based on any deliberate action by a group member, as described in Paragraph 7.13 of Chapter 7 on Intra-Group Services and Examples 1 and 2 of Section D.8 of Chapter 1 on MNC group synergies.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

The LCITA provides guidance on the factors that need to be considered for purposes of evaluating the credit ratings of the related parties in question when the arm's length financial guarantee fee is estimated. Article 2-3(4)-1 of the Enforcement Rule (ER) of LCITA lists the following factors: past financial information, future financial information (with a reasonable degree of predictability) and nonfinancial information such as country risk, industry characteristics, the level of technology involved, market power and competitiveness, and industry overall credit risks.

The NTS considers credit ratings and related information provided by global rating companies such as Moody's, S&P, and Fitch. When taxpayers' cases involving financial guarantee fees are examined, the NTS also uses Moody's RiskCalc for purposes of performing a credit rating analysis for foreign affiliates.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

The DealScan database and Bloomberg database are typically used for comparable loan benchmarking purposes.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The LCITA provides the following safe-harbor rules. According to Article 6-7-(2) of the PD, Article 2-2-(2) of the ER specifies interest rates deemed arm's length as follows:

1) Outbound transactions (domestic lender/foreign borrower): Interest rate on overdrafts stipulated in Article 43-22 of, Ministerial Decree of Corporate Tax Act (4.6% as of the time of this article)
2) Inbound transactions (foreign lender/domestic borrower): 12-month Libor applicable to the loan currency on the last day of the preceding fiscal year plus 0.015 (i.e., 1.5%). If there is no 12-month Libor rate applicable to the loan currency, use 12-month US dollar Libor rate plus 1.5%.

Effective February 7, 2017, Korean taxpayers can choose to apply the above interest rates for Korean tax return filing purposes.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

The authors have not seen the tax authorities dealing with a case involving negative interest rates. If such a situation arises, however, theoretically as long as a taxpayer provides an analysis to support the negative interest rate with reliable third-party evidence, the tax authorities will take the analysis into full consideration.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

There are issues related to the applicability of withholding taxes to certain types of income, depending on the way intra-group lending (loan) transactions are characterized. For example, interest income from a de facto loan can be disguised as dividends, business income or capital gains from securities dealings where such incomes are not subject to tax according to tax treaties; or certain income from an intercompany financial transaction can be disguised as interest income where interest income is not subject to tax according to tax treaties to avoid withholding taxes applicable to interest income. In general, the tax authorities advise taxpayers to review such possibilities carefully before they make payments to foreign related parties.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

A new rule, effective from taxpayer's fiscal year beginning on January 1, 2018, was introduced into the

LCITA to limit expense deductions for hybrid mismatch arrangements (BEPS Action 2). The following point is worth highlighting: in cross-border transactions involving hybrid financial instruments between a domestic company (including a Korean permanent establishment of a foreign corporation) and its foreign related party, when (a) financial instruments have debt or equity characteristics at the same time, but are treated as debt in one country (e.g., Korea) and treated as equity in the other country, so that therefore (b) the deductible amount is partially or entirely untaxed in a counterpart jurisdiction for a certain period (i.e. until the end of the recipient's fiscal year commencing within 12 months after the end of the payer's fiscal year), the expense deduction will be denied for the amount of payment which is untaxed in a counterpart jurisdiction (but only for that part).

In principle, when a corporate tax return is filed, the taxpayer is required to subtract interest expense untaxed in the counterpart jurisdiction from deductible expenses, and is also responsible for the burden of proof on the taxation of the deducted expenses in the counter jurisdiction.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

The Corporation Tax Law (CTL) provides clear guidance on determining income of a PE. Article 130 of the Presidential Decree of the CTL states that the computation of the domestic-source income of a domestic place of business (i.e., permanent establishment in the Korean CTL context) is to be based on an arm's length price, calculated under one of the arm's length methods specified in the LCITA. In other words, this provision clearly demands the application of the arm's length principle to internal dealings that occur between a domestic place of business and the other parts of a foreign corporation. As per specific rules to apply the arm's length principle of Article 130 of the CTL PD, Article 64(2) of the Enforcement Rule of the CTL stipulates that a taxpayer must take into account the functions performed, risks assumed, and assets employed by a domestic place of business and also by the other parts of a foreign corporation in computing the profits attributable to the domestic place of business for an internal dealing. However, Article 64(1) of the CTL Enforcement Rule states the following two exceptions in determining the deductibility of expenses associated with an internal dealing: i) interest expenses incurred for fund transactions and ii) service fees incurred for guarantee transactions.

It is the authors' view that this approach under the arm's length principle to cross-border internal dealings in a CTL context is consistent with the separate-and-independent-entity approach to the determination of the profits attributable to a permanent establishment in Article7(2) of the 2010 OECD Model Tax Convention (OECD Model).

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Article 6-2(3) of the LCITA-PD specifies the methods that are to be used to calculate the arm's length price of a guarantee fee. The specific methods under Article 6-2(3) are as follows:

1) A method based on the guarantor's expected risk and cost;
2) A method based on the guarantee's expected benefit to the overseas affiliate; and
3) A method based on both the guarantor's expected risk and cost and the guarantee's expected benefit.

Article 6-2(4) of the LCITA-PD provides two safe harbor rules whereby the following guarantee fees are deemed to be arm's length:

1) Guarantee fees computed based on the difference between interest rates with and without a loan guarantee when the interest rate difference is calculated by the finance company providing the loan in question (the fee should be limited to the amount that can be confirmed through the interest calculation report prepared by the finance company making the loan); and
2) Guarantee fees computed according to the conditions prescribed by the National Tax Service (NTS) commissioner as a method to calculate the arm's length price based on a guarantee's expected benefit.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Article 14 of the LCITA provides guidance on interest deduction limits. If the sum of the amount borrowed from a foreign controlling shareholder (including loans provided by related parties of the foreign controlling shareholder) and the amount borrowed by third parties with a guarantee from the foreign controlling shareholder exceeds two times (six times for financial institutions) the amount of investment made by the foreign controlling shareholder, the taxpayer is not allowed to deduct the interest paid on the excess amount when the corporate tax return is filed.

The authors think that the existence of thin capitalization rules does not have a significant impact on the way companies make decisions about their transfer pricing policies, although the volume or size of intercompany loans in consideration may vary going forward.

Tae Hyung Kim, Ph. D economist, former national leader of Global Transfer Pricing Group of Deloitte Korea and Mr. Seong Kwon Song is a tax principal at Deloitte Anjin Tax LLC, Seoul, Korea.

They may be contacted at:
kimtaehyung62@gmail.com;
sksong@deloitte.com;
http://www2.deloitte.com/kr/en.html.

Luxembourg

Peter Moons, Gaspar Lopes Dias, and Fernanda Rubim
Loyens & Loeff Luxembourg

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related-party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Article 56bis of the Luxembourg Income Tax Law (ITL) refers to the use of the five transfer pricing methods described in the OECD TP Guidelines (TPG) and provides for the selection of the method that best approximates arm's length prices in each specific case. Other methods are admissible provided that it can be shown that another method is an appropriate measure of profitability to the case at hand. The above is also the position of the Luxembourg tax authorities (LTA) in respect to transfer pricing methods. In particular, the Capital Asset Pricing Model (CAPM) method is often used for in and on-lending transactions. For related-party debt pricing, the Comparable Uncontrolled Price (CUP) method is generally applied by taxpayers and by the LTA, with or without comparability adjustments where appropriate. Furthermore, the CUP method may in principle be applied together with other corroborative methods such as financial modeling of cash flows and blended cost of finance analyses (such methods may for instance be used to substantiate the ideal loan-to-value, by way of determining at what debt-to-equity ratio the return on equity would be maximized). Other specific financial methods (e.g., Expected Loss) are also used in certain cases to approximate an at market debt-to-equity ratio for the overall financing of the taxpayer's debt investments. Both taxpayers and the LTA use data derived from publicly available sources and/or subscription based databases as evidence for market interest rates.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

Neither Luxembourg legislation, administrative practice, nor case law differentiate between outbound and inbound transactions.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a) What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

Under article 56bis of the ITL, the actual conduct of the parties must be considered when accurately delineating a transaction. Intra-group contractual arrangements should reflect the actual transaction entered into. If the actual conduct of the parties differs from what was contractually agreed, it is the actual conduct of the parties that must be taken into account in delineating the transaction. Article 56bis(7) of the ITL even provides for the non-recognition of a transaction, or parts thereof, when it lacks commercially rationality. This entails, for instance, the analysis of the commercial rationality of agreed terms and conditions, if any (e.g., the term of the intra-group debt may be revisited in light of the overall investment horizon of the assets financed).

The classification of an instrument as debt or equity under Luxembourg income tax rules is of relevance alongside transfer pricing considerations. In Luxembourg, an interest-free loan (IFL) may in specific cases be seen as either debt or equity, depending on its particular features. In this respect, some guidance may be found in Luxembourg jurisprudence, referring back to the parliamentary history of the ITL.

In case no. 38357C of 26 July 2017, the Administrative Court, citing the relevant parliamentary history, ruled that a debt instrument granted by the shareholders should be reclassified as equity, if the normal way of financing, dictated by serious economic or legal considerations, would have been to increase the capital instead and it is clear from the circumstances of the case under review that the form of a loan was chosen exclusively for tax reasons. Elements that would permit the presumption that a shareholder loan constitutes equity include uncommon characteristics of the terms and conditions of the loan, notably in relation to (i) the interest and repayment schedule; (ii) the use of the proceeds of the loan for funding a long-term fixed asset; (iii) the absence of security arrangements; (iv) the disproportion between equity and debt financing; as well as (v) the circumstances under which the loan is granted.

From these criteria it follows that both an absence of interest and an absence of a written agreement could lead to the presumption that the loan constitutes equity, although these elements are presumably not sufficient by themselves to conclude this.

b) Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

The process of estimating the credit worthiness of the borrower is complex and heavily dependent on the specific facts and circumstances. There is no specific Luxembourg guidance on factoring implicit support. Taxpayers may refer to the OECD TPG, as well as international case law (i.e. General Electric), rating agencies' documents, or Basel norms applicable to banks and financial institutions. In practice, the LTA accepts the use of the group's credit rating to the extent it can be reasonably shown that the subsidiary is core to the strategy of the multinational. This can be viewed as a necessary interpretation of the arm's-length standard, as third parties may also take implicit support into account.

c) What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

In evaluating the creditworthiness of a borrower, relevant factors would include: the industry sector where the borrower operates or to which it is exposed; its trends as specificities; the risks of the country(ies) from where the borrower derives its revenues; its financial position and arrangements; financial balance sheet and profit and loss statement; the functional profile and position in the global value chain; any particularities of its assets; and any other elements with a potential impact that could be taken into account. As a second step, the terms and conditions of the debt instrument, namely its payment ranking (i.e. senior vs. subordinated, secured vs. unsecured); principal amount; currency; fixed vs. floating interest rates; maturity; options; repayment schedule; covenants and securities; etc. should be considered.

d) What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Public available data from official sources (e.g., countries' bond ratings, default spreads, universities' analysis) and subscription-based databases (e.g., Bloomberg, Thompson Reuters, Moody's, etc.) are used for debt pricing.

e) What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

Prior to the first comprehensive administrative circulars dealing with intra-group finance issued in 2011 (i.e. circulars ITL No. 164/2 of 28 January 2011 and No. 164/2bis of 8 April 2011), administrative safe harbors were admissible in Luxembourg for a period, based on a table with interest rate brackets. Currently, there is a simplification measure under Circular ITL No. 56/1 – 56bis/1 of 27 December 2016, applicable as of January 1, 2017, that indicates that when a group financing company pursues a purely intermediary activity, it is considered that the transactions are deemed to comply with the arm's length standard if the entity receives a return of 2% after-tax on its debt investments (return on assets). According to this circular, this percentage will be regularly reviewed by LTA based on relevant market analyses. Taxpayers that wish to opt for this measure should include this option in its tax return and would not need to prepare a transfer pricing documentation report. Further, according to the 2017 Circular, as it regards undertakings comparable to financial institutions, a 10% return on equity (after tax) can be considered indicative of an arm's length compensation. Also, this percentage is to be regularly updated by the LTA, according to the circular.

f) How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

Typically, to the extent that it translates into a conservative approach from a Luxembourg income tax perspective, negative floating base interest rates can be floored at zero. This is something to be evaluated on a case-by-case basis.

g) Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

With article 56bis of ITL, in force as from January 1, 2017, Luxembourg incorporated into its domestic law important aspects of actions 8 to 10 of the BEPS G20/OECD Report which emphasize the relevance of the functions performed by people. In this regard, Luxembourg intra-group financing companies which lack organizational and economic substance (e.g. active and qualified managers capable of controlling risks) could be considered as 'conduits' and, thus, not entitled to the interest income. This analysis is made alongside other considerations in regard, for instance, to beneficial ownership under tax treaties. In these cases, the LTA may exchange information. Against this background, some taxpayers are reviewing and reorganizing their operations accordingly, especially where treaty benefits are intended to be claimed.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

Luxembourg implemented the amendments to the Parent-Subsidiary Directive or PSD (2014/86), so that as from January 1, 2016 dividend income can only be tax exempt to the extent that the payment was not deductible at the level of the distributing subsidiary. This rule is limited to EU subsidiaries. Even though Luxembourg does not yet have a bill of law for implementing the Anti-Tax Avoidance Directive (ATAD) 1 and the ATAD 2, it is expected that the Directives will be implemented and enter into force as from January 1, 2019 and January 1, 2020, respectively. It is not expected that Luxembourg will go beyond those Directives.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Luxembourg endorses the Authorized OECD Approach (AOA) for the Attribution of Profits to Permanent Establishments and thus, such guidance should apply in this respect.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?). How is the appropriate charge for a guarantee determined?

Luxembourg follows the guidance of the OECD TPG in this regard. To the extent that third parties in comparable circumstances would have paid for the guarantee, this should be reflected in the intra-group setting as well (whether a separate guarantee fee is paid or an adjustment to the interest rate is performed). There are several ways to determine the benefit of the guarantee and price guarantee fees, including analysis based on Credit Default Swap (CDS) spreads, the cost of the guarantee for the guarantor, and the benefit of the guarantee for the borrower.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

At present, there are no thin capitalization rules in Luxembourg law. The LTA in practice observes a debt-to-equity ratio of 85:15 for holding companies, so that interest expenses on debt exceeding such ratio could be denied by the LTA and such interest reclassified as a hidden dividend distribution. In addition, interest expenses may be non-deductible if incurred in connection with assets which have generated accrued tax-exempt income or to the extent such interest expenses exceed arm's length interest rates in the case at hand. Luxembourg currently does not have interest deduction limitation rules as advanced by the G20/OECD's BEPS Project. This will change with the ATAD 1, expected to enter into force by January 1, 2019. We don't expect that this will reduce the need to enforce transfer pricing in regard to related-party debt. The arm's length standard should apply in determining the taxable profits of Luxembourg taxpayers prior to the application of any interest deduction limitation rules. The debt-financing bias may remain namely by way of withholding tax-free cash repatriation, as currently interest is not subject to Luxembourg withholding tax while dividends are subject to withholding tax at a rate of 15%. Moreover, Luxembourg financing companies borrowing and lending intra-group would not be targeted by ATAD 1, to the extent interest income and expenses closely match.

Peter Moons is a Tax Partner and Head of the Transfer Pricing team at Loyens & Loeff Luxembourg. Gaspar Lopes Dias is a Tax Adviser and Transfer Pricing Specialist at Loyens & Loeff Luxembourg. Fernanda Rubim is a Tax Adviser and Transfer Pricing specialist at Loyens & Loeff Luxembourg. They may be contacted at:

peter.moons@loyensloeff.com
gaspar.lopes.dias@loyensloeff.com
fernanda.antunes.rubim@loyensloeff.com
https://www.loyensloeff.com/en-us/home

Mexico

Moises Curiel and Allan Pasalagua-Ayala
Baker & McKenzie, Mexico

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Article 180 of the Mexican Income Tax Law (MITL) established transfer pricing methods for testing intercompany transactions that are aligned with the OECD Guidelines. The Law does not expressly indicate that any one particular method is better for testing the arm's-length nature of interest rates in controlled transaction; however, the MITL establishes a general hierarchy for the application of TP methods beginning with the Comparable Uncontrolled Price (CUP) method.

In accordance with the OECD TP Guidelines, Article 180 of the MITL allows taxpayers to use another method only when the CUP method is not appropriate to determine the arm's-length nature of the tested transaction. Whether using the CUP method or other permissible TP methods, the taxpayer must show that the method used is the most appropriate or most reliable based upon all available information, giving preference to the RPM or CPM over the PSM or TNMM. Nevertheless, any method could be used if it proves to be the best method on a case-by-case basis.

Local tax inspectors tend to apply the CUP method to evaluate intercompany interest rates. Absent the existence of internal comparables, corporate debt bonds are usually the best source of data to identify comparable uncontrolled interest rates to benchmark an intercompany loan.

Article 179 of the MITL establishes the comparability criteria and provides that for financial transactions, taxpayers must consider elements in their analysis including the loan amount, its terms, warranties, and the borrower's solvency. During an audit, tax inspectors generally apply a strict comparability analysis considering, among other characteristics, the currency of loan; type of interest rate (fixed or variable and if variable, the base interest rate used); the term of the loan; type of loan; and warranties, etc.

In addition to compliance with transfer pricing regulations and having to prove the business reasons to receive a loan, Mexican regulations establish that foreign liabilities must be part of an inflation adjustment that taxpayers must estimate and applies each fiscal year. For liabilities, the inflation adjustment translates into taxable income. Thus, in a comprehensive analysis, which takes into consideration the amount of interest to be paid plus the inflation effect and the withholding tax, any potential benefit from lending to a Mexican subsidiary tends to be minimal.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

Generally, tax inspectors follow the same approach and methods to determine the arm's-length nature of intra-company financial transactions, regardless of whether they are evaluating outbound or inbound transactions. The application of valuation methods primarily depends on the audit activity. It is more common to see Mexican tax authorities challenging the deduction of an interest expense by a Mexican entity, rather than the income received from an outbound transaction.

Differences between the arm's-length nature of inbound and outbound transactions relate primarily to thin capitalization rules. In Mexico, thin capitalization rules, established in Article 28, Section XXVII of the MITL, state that the interest paid to related parties will not be deductible in amounts exceeding the 3:1 ratio of liabilities to the equity of the company. However, the rule does not apply to entities that are part of the financial system (as defined in the MITL); entities engaged in the construction, operation, or maintenance of infrastructure linked to strategic areas of the country; or entities engaged in the generation of electric power. Other exemptions and waivers regarding thin capitalization rules may apply. For example, taxpayers who obtain an APA for intercompany loan transactions are not subject to this limitation.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

For many years, the main focus of an intercompany loan analysis has been to determine if the interest rate paid by the local borrower complies with the arm's-length principle. More recently, tax authorities also began focusing on and challenging the purpose and reasonableness of the loan.

The taxpayer is expected to demonstrate that there is a reasonable basis for providing the loan at the time it was made, and it must also indicate what the use and benefit of the loan was. Taxpayers are also expected to have an intercompany agreement establishing the terms of the loan (e.g., principal, interest rate, term, etc.). Tax authorities usually don't question whether the loan is, in fact, an equity contribution provided the borrower maintains within the 3:1 debt to equity ratio required under Mexico's thin capitalization rule.

There are no specifics in Mexico's transfer pricing regulatory regime that dictate whether a borrower should be evaluated on a stand-alone basis or whether the borrower's passive association with its group should be considered if the association results in a better credit rating. Usually the borrower is evaluated on stand-alone basis, and implicit support from the group is not assumed. There has to be a formal guarantee from an affiliate for the tax authorities to consider the benefit. When there is a formal guarantee, tax officers usually do not oppose this condition, as it would translate into a lower interest rate and a lower deduction amount.

Aside from guarantees or a support group, other factors are considered in evaluating the borrower's credit worthiness. For example, some models incorporate the industry in which the borrower does business and its competitive position into the analysis.

To assess the arm's-length nature of an intracompany financing transaction, it is common to use the rates on coupons associated with corporate bonds as a benchmark. There are a few Mexican databases that contain information on all public bonds issued by corporations in Mexico, most of which are in Mexican pesos (only a few are in U.S. dollars or Euros). For intercompany loans in U.S. dollars or Euros, global databases on corporate bonds can be used, but an analysis must be conducted to determine if a country risk adjustment is warranted.

Transfer pricing provisions in Mexico don't contemplate a safe harbor rule for intercompany loans, nor have the tax authorities indicated their intention to include such provisions.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

In sync with the beginning of the BEPS program, as part of the 2014 tax reform, Mexico introduced regulations to prevent BEPS through hybrid mismatches. In particular, for financial transactions, Article 28 of the MITL does not allow a deduction for interest paid to a foreign party that controls or is controlled by the resident party if (i) the recipient is considered a transparent entity for tax purposes; (ii) for tax purposes, the payment is nonexistent in the country where the entity resides; or (iii) the recipient party is not required to include the payment as part of its taxable income under its jurisdiction's rules.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Mexico's transfer pricing regulations are very concise, and according to Article 179 of the MITL, Mexico relies on the OECD Guidelines for its interpretation of the tax law. This is the case with attribution of income to a PE where the local regulation has no specific rules. Under these circumstances, the OECD's report on attribution of profits to PEs should be followed.

Consequently, Mexican taxpayers are supposed to follow the functionally separate entity approach described in OECD's report. This is especially important for debt financing; taxpayers should pay attention to the attribution of free capital and interest-bearing debt. The OECD Report considers several approaches to attribute funding to the PE, and taxpayers should use the most appropriate approach on a case-by-case basis.

Finally, it is also important to consider the OECD's comments on the reasonableness of, or restrictions on the PE having the same credit worthiness as the whole enterprise or vice versa.

It is important to mention that Article 26 of the MITL disallows deductions for interest paid by the PE to the central office it belongs to; therefore, the interest bearing debt attributed to the PE has to be from third parties or other entities from the group that are different than the central office of the PE.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

There are no specific rules to determine when a guarantee fee must be accounted for, but based on Mexico's practice, it is likely that the tax authorities will require taxpayers to prove that an explicit guarantee is necessary and that it benefits the local entity.

If a taxpayer can reasonably prove that the explicit guarantee provided by its related party improves its credit worthiness, and that this was considered by the lender to grant a lower interest rate, an adjustment to the interest rate should be accepted by tax authorities. The exact charge for the guarantee depends on the facts of each case, but it should be an amount between the spread of interest to be paid by the borrower with and without guarantee.

An explicit guarantee might alternatively be a requirement for a borrower to receive a loan at all. Taxpayers should have supporting documentation to prove that there is a reasonable basis for the guarantee and must also demonstrate that, but for the guarantee, they would not have received the loan. In these cases, a guarantee fee as a percentage of the amount of the loan guaranteed could be accepted by tax authorities as payment for the explicit guarantee. Different databases provide information on guarantee fees as a percentage of the loan to be used as uncontrolled comparable transactions using the CUT method.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

To date, Mexico has not adopted interest deduction limits based on ratio approaches suggested by the OECD in Action 4 of the BEPS program, and it does not appear to be something Mexico will implement in the near future. However, Mexico has thin capitalization rules established in Article 28, Section XXVII of the MITL, which limit the deduction of interest paid to related parties in amounts exceeding the 3:1 ratio of liabilities to the equity of the company.

Mexico has seen successful cases of unilateral APAs regarding thin capitalization where tax authorities allow a higher ratio of debt to equity to taxpayers that prove that their business requires high level of debts and that comparable third parties operate with similar rates of debt.

Moises Curiel is Principal-Director of the Latin American Transfer Pricing Practice at Baker & McKenzie in Mexico City, Mexico and Allan Pasalagua-Ayala serves as Tax Counsel at Baker & McKenzie in Mexico City, Mexico. They can be contacted at:

Moises.Curiel@bakermckenzie.com

Allan.Pasalagua-Ayala@bakermckenzie.com

Http://www.bakermckenzie.com/en/locations/latin-america/mexico/

New Zealand

Leslie Prescott-Haar, Stefan Sunde, Sophie Day, and George Condoleon
TP EQuilibrium I AustralAsia LP; Duff & Phelps LLP

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Section GC 13(2) of New Zealand's Income Tax Act 2007 (ITA 2007) outlines the five available methods for the pricing of controlled cross-border transactions, which include the comparable uncontrolled price (CUP), resale price (RP), cost plus (CP), transactional net margin (TNMM) or comparable profits (CPM), and profit split (PS) methods. The existing legislation and New Zealand Inland Revenue (IRD) guidance do not have an explicit preference for any particular transfer pricing method in respect of finance transactions. However, in cases where reliable and/or reliably adjustable CUP benchmarking data exists, the historic practice of the IRD and taxpayers has favored this method. The "cost plus" method, based upon an uplift on the multinational group's cost of funds and/or a base interest rate such as LIBOR, may also be relevant. However, reliable and comparable internal uncontrolled pricing data often does not exist. The following is drawn from the IRD website:

- *Most interest rate analyses begin with an appropriate reference rate or base indicator. For variable rate loans, this is typically the bank bill rate; for fixed rate loans, usually swap rates are applicable.*
- *Financing is mostly about margins. The key factor in determining interest rate margins is credit risk or the probability of default (which includes term to maturity). Factors such as liquidity, ranking (senior or subordinated) and early repayment have only limited impact compared with credit risk. Thus the margin added to the base indicator in order to arrive at an interest rate is almost entirely compensation for credit risk.*
- *The margin over the base indicator is best determined by reference to credit ratings.*

Expanding on the above extract, the IRD typically relies upon the guidance contained in Standard & Poor's (S&P) Group Rating Methodology paper (November 2013) to determine the extent of notching for implicit parental support in order to determine a borrower's notched credit rating.

In December 2017, the New Zealand government released the Taxation (Neutralising Base Erosion and Profit Shifting) Bill, in particular, proposed new draft sections GC 15 – 18 of the ITA 2007 that would likely materially alter the transfer pricing of inbound finance transactions. In broad terms, the Bill provides a stepped approach to determining the credit rating of a New Zealand borrower that must be undertaken, once the law has been amended, for purposes of pricing inbound financial transactions. Once passed the final legislation will have an effective date of July 1, 2018. The stepped approach will result in one of the following credits ratings for a New Zealand borrower:

1. **Low BEPS risk loans and low value loans** – the borrower's unadjusted credit rating, factoring implicit support under the mentioned S&P paper [GC 16(7)]; or
2. **High BEPS risk loan not within a controlled group** – a restricted credit rating applies based on the higher of: (i) a BBB- credit rating, or (ii) the rating determined based on an adjusted debt:equity ratio for the New Zealand borrower [GC 16(8)]; or
3. **High BEPS risk loan within a controlled group** – the application of the group credit rating minus one notch [GC 16(9)], or the borrower's unadjusted rating, factoring implicit support [GC 16(7)]. The borrower is expected to apply the higher credit rating under this third limb of the draft Bill.

The credit ratings attributable to borrowers in outbound financial transactions are not directly impacted by the Bill. As such, it is anticipated that the IRD's reliance on the S&P paper will continue to prevail in these transactions, which represent a limited proportion of New Zealand's cross-border controlled finance transactions.

In respect of the credit margin (inbound and outbound), the IRD accepts major databases that provide reliable external benchmarking data, such as Bloomberg's yield curve data or S&P LoanConector's coupon interest rate data. Taxpayers must explain and evidence their selection and application of relevant benchmarking data to determine an appropriate margin/spread, and document this appropriately.

It is noted that, at the time of writing, this Bill remains in draft form and its provisions are under some scrutiny, thus revisions to the final law are likely.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

Refer to the discussion above, Under the proposed Bill, a differing approach would be adopted for inbound versus outbound financial transactions. However, in practice, the IRD generally prefers a consistent approach in respect of the pricing of inbound and outbound controlled financial transactions.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

The most readily accessible starting point is to consider the terms and conditions of an intercompany loan agreement or loan term sheet, should such be available. Subsequently, whether a written agreement is available or not, the actions and accounting of the parties (i.e., borrower, lender, and any guarantor(s)) should be analyzed and documented. Generally, the terms and conditions contained in loan agreements have been respected for New Zealand transfer pricing purposes in the past, except if materially inconsistent with the arm's-length principle – whereby "aggressive" transactions would typically be scrutinized under the anti-avoidance legislation by the IRD. However, forthcoming changes to New Zealand's transfer pricing law under the proposed Bill [section GC 18(2)] establish a series of "exotic features" to be disregarded in considering the applicable interest rate/margin on the loan.

Additionally, proposed wider transfer pricing reforms without draft legislation under debate includes an intention for recharacterization rules similar to those outlined in paras. 1.123 – 1.124 of OECD's Action 8-10, but potentially wider reaching. That said, given the above-discussed exotic features, such recharcaterization rules may be less relevant to finance transactions.

Guarantee fees are not included as an exotic feature in the Bill. The Commentary on the draft legislation (Example 2) provides an outline of how to appropriately measure the value of formal guarantees, wherein the spread attributable to the difference between the borrower's notched rating i.e., the standalone credit rating, after taking into account implicit parental support, and the group's credit rating, is deemed to be the appropriate margin to assess for purposes of determining a guarantee fee. Refer further to the response in (6) below.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

New Zealand has no transfer pricing case law, and as such relies to some extent on the persuasive judgements handed down in similar jurisdictions (e.g., *Chevron* in Australia, and *GECC* in Canada).

Refer to the discussion in (1), above, in respect of the IRD's approach to implicit parent support. At present, the transfer pricing landscape remains unsettled with respect to the concept of notching, and the IRD's view often differs from that of taxpayers and advisors in respect of its interpretation and application of notching for implicit parental support, while adhering to the arm's-length principle. The proposed Bill would likely, for inbound cross-border controlled finance transactions, arguably remove much uncertainty, but also, rely on the arm's-length principle as the guiding principle in these transfer pricing matters.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

As mentioned, section GC 18(2) of the Bill would disregard, for transfer pricing purposes, various features of the borrower's (and lender's) loan terms and conditions as an "exotic feature." As outlined in the commentary on the Bill, these include:

- payment-in-kind or other forms of interest payment deferral;
- options which give rise to premiums on interest rates (for example, on early repayment by the borrower);
- promissory notes or other instruments which do not provide rights to foreclose/accelerate repayment;
- convertibility to equity or other exchange at the option of the borrower; and
- contingencies (for example, where interest is repaid only under certain conditions).

As indicated, once enacted, the Bill will also likely affect on the borrower's assessed credit rating for pricing purposes.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Refer to the response in (1).

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

The IRD website provides a safe harbor in respect of low value intercompany loans. The relevant current extract from the IRD website is below:

For small value loans (ie, for cross-border associated party loans by groups of companies for up to $10m principal in total per year), we currently consider 250 basis points (2.5%) over the relevant base indicator is broadly indicative of an arm's-length rate, in the absence of a readily available market rate for a debt instrument with similar terms and risk characteristics.

A safe harbor has also been drafted into the Bill [GC 16(1)(a)] such that for small value loans (principal NZD 10 million), the unadjusted rating approach [GC 16(7)] should be adopted.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

In New Zealand, including during the recent global financial crises, base interest rates have never been negative, nor especially close to it. Where, in practice, an outbound loan is made into a country by a New Zealand Group/parent company, then such market negative interest rates should be taken into account for the purpose of pricing the finance transaction, but it would be highly preferable that the NZ Group/parent company did not lend at a loss. On the inbound side, negative interest rates may be taken into account in a review or audit conducted by the IRD, for purposes of considering the arm's-length nature of an inbound loan to a New Zealand borrower.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

New Zealand has a comprehensive thin capitalization regime which limits the amount of debt a taxpayer can claim interest deductions on in New Zealand. The current safe-harbor threshold is 60% (debt/assets), effective from the March 2012 income year.

The Bill proposes a modification such that a taxpayer's maximum debt level would be set with reference to the taxpayer's assets net of its non-debt liabilities (that is, its liabilities other than its interest-bearing debts). Some common examples of non-debt liabilities are accounts payable, reserves and provisions, and deferred tax liabilities.

The Bill also proposes a number of other small changes to the thin capitalization rules, such as a special rule for infrastructure project finance that would allow full interest on third-party debt to be deductible even if the debt levels exceed the thin capitalization limit, provided the debt is non-recourse with interest funded solely from project income.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

The December 2017 Bill also includes the New Zealand government's adoption of the OECD's recommended approach to hybrid mismatches, with modifications, such as an exemption for local companies with foreign branches, and delayed application dates for some limited partnerships and trust structures. The changes will also come into effect on July 1, 2018. This follows the prior released Cabinet Paper in August 2017.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

As in the response to (5), the December 2017 Bill also adopts a number of reforms in respect of the attribution of income to permanent establishments. Generally the IRD does not accept profit margins on transactions (or dealings) between a branch and its head office, including credit spreads on financial transactions. The extract from the IRD website below reflects this principle:

A PE is not legally distinct from the rest of the enterprise the same way a separate legal entity is legally distinct from other enterprises within the same MNE group.

For transactions between separate legal entities, the determination of which enterprise owns assets, which bears risks and which possesses capital is determined by legally binding contracts or other confirmed legal arrangements. The legal position in a PE context is quite different - there is no single part of an enterprise which legally owns the assets, assumes risks, possesses the capital or enters into contracts with separate legal entities. There are no legal transactions between different parts of a single entity - the now familiar limited risk structuring between separate legal entities has no legal meaning within a single legal entity.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

See response to (3)(a).

Guarantee fees must be determined with reference to "interest savings," after factoring in implicit parent support, under New Zealand transfer pricing guidance. The guarantee fee is often practically computed as a 50:50 split of the relevant interest savings resulting from a formal guarantee.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

See the responses to previous questions.

Also noteworthy is the IRD/New Zealand government's decision not to adopt the OECD's recommended approach under its BEPS Action 4 – Interest Deductions. Ultimately the IRD remains of the view that New Zealand's thin capitalization regime, together with the previously discussed interest limitation reforms contained in the December 2017 Bill, are an appropriate approach for New Zealand moving forward. In its March 2017 discussion document, the IRD in paras. 2.16 – 2.18 noted the following:

2.16 This discussion document does not consider the issue of whether New Zealand should change to an EBITDA-based rule. No decision on this has been taken at this stage. The purpose of this discussion document is to explore whether there are some rules that could address some of the disadvantages of an asset based rule outlined in the table above.

2.17 This is because, overall, we consider that our current approach to limiting interest deductions is working well. Accordingly it seems preferable to put forward specific proposals that seek to address some of the problems we are currently seeing in our rules without abandoning this general framework.

2.18 In particular, we consider an asset-based thin capitalisation regime must be bolstered by rules to restrict the ability of taxpayers to use excessive interest rates for related-party loans. A proposed rule to prevent this is discussed in chapter 3. We also consider that our rules will be more robust and effective if there is a change to how total assets are determined. A proposed rule to achieve this is discussed in chapter 4.

Leslie Prescott-Haar is the managing director of TP EQuilibrium | AustralAsia LP (TPEQ). Stefan Sunde is a Senior Analyst at . Sophie Day is an Analyst at TPEQ. George Condoleon is the Transfer Pricing Director at Duff and Phelps. They can be contacted at:

Leslie.prescotthaar@ceterisgroup.com;

Stefan.Sunde@ceterisgroup.com;

Sophie.Day@duffandphelps.com;

George.Condoleon@duffandphelps.com

http://www.duffandphelps.com/

Russia

Evgenia Veter, Yuriy Mikhailov, and Timur Akhmetzianov
Ernst & Young, Moscow

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

According to Russian tax legislation, the arm's-length analysis of interest rates on related-party loans should start with the "safe harbor" test which provides threshold values established by Article 269 of the Russian Tax Code ("RTC").

When the "safe harbor" test is not met, the arm's-length analysis of interest rates on related-party loans should be performed in accordance with the transfer pricing methods.

Russian transfer pricing ("TP") rules are established in Section V.1 (Articles 105.1 – 105.25) of the RTC and provide for a hierarchical approach to the application of TP methods, with the Comparable Uncontrolled Price ("CUP") viewed as the preferred method and the Profit Split as the method of last resort.

Based on the above, the CUP method is considered the most appropriate method for evaluating arm's-length interest rates on related-party loans with the first preference for the assessment of any internal CUPs. When internal CUPs are not comparable or do not exist, then external CUPs has to be applied.

The Russian tax authorities generally suggest starting the arm's-length analysis of interest rates on related-party loans with a preliminary risk assessment, by applying several tests, e.g., break-even (whether the interest rate applied on the related-party loans is lower than interest rates on borrowings received by the lender from unrelated parties) or benefit (whether realistically available options exist to place money into banking deposits at higher interest rates). If any risks are identified, a full scope TP analysis would be expected.

For the TP analysis, it is common to use both Russian databases (CLoans, CBonds and RusBonds) as well as international ones (Thomson Reuters, LoanConnector and Bloomberg), depending on the origin of a loan and the comparability criteria to be applied.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

Generally, there are no special requirements in the Russian TP rules that differentiate the application of a particular TP method between inbound and outbound transactions.

However, Article 105.5 of the RTC provides comparability criteria for benchmarking purposes where a geographic factor or markets in which transactions are executed have importance. At the same time the RTC provides that differences in markets in which transactions are concluded should not have a material effect on the commercial and (or) financial conditions of transactions concluded in those markets or it should be possible to eliminate the effect of any such differences by means of making appropriate adjustments. Hence, local Russian comparables are applied on a priority basis when establishing arm's-length ranges of interest rates for inbound transactions, and foreign comparables are preferred for outbound transactions if a borrower is located in the foreign markets. However, in practice, it is often difficult to identify local Russian comparables in relation to the inbound loans where borrowers are located in Russia, and foreign comparables are often used with relevant comparability adjustments, e.g., currency and country premium.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis.How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

The Russian tax authorities are extremely attentive to transactions by Russian taxpayers involving foreign related parties, including related-party loan transactions, when Russian taxpayers incur expenses. The Russian tax authorities may challenge interest expense incurred by domestic affiliates or reclassify the transaction into an equity infusion based on the assumption that it is economically unjustified.

Although, according to the Russian court practice, taxpayers conduct business at their own risk and have the right to self-assess the efficiency and reasonability of their businesses, Russian tax authorities may challenge interest expense incurred by the taxpayer on the following grounds:

- the loan is not economically justified and is not aimed at revenue generating activities; or
- the transaction is aimed at receiving of an unjustified tax benefit.

The "unjustified tax benefit" doctrine arises from Russian court practice wherein a tax benefit (including that achieved via expense recognition) may be questioned if the transaction is not accounted for in accordance with its real economic substance or it does not have a legitimate business purpose.

Recently, a new provision has been introduced into the RTC making the judicial "unjustified tax benefit" concept officially into a general anti-abuse rule ("GAAR") under Article 54.1 of the RTC.

Based on the above-stated grounds, the tax authorities may claim that the "borrowing" is, in fact, an equity infusion allowing them to reclassify the interest expense into dividends if they prove that the related-party loan transaction is not economically justified.

The tax authorities and courts examine the following factors when assessing the economic substance of a related-party loan transaction:

- Does the loan agreement contain the tenor of the transaction?
- Does the loan agreement contain the interest rate? Is this interest rate arm's length?
- Do all parties involved in the loan transaction follow its essential conditions without any violation?
- Does the borrower have the intention to fulfill its debt obligations?
- Does the lender have the intention to request the repayment of the loan?

When a loan transaction is executed without a written agreement, it cannot not be recognized as a transaction for the Russian tax and transfer pricing purpose.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

Russian tax authorities have not promulgated regulations nor issued official guidance concerning the assessment and recognition of implicit support. Additionally, Russian courts have not decided any court cases in relation to the implicit support issue.

The credit profile of the borrower and its creditworthiness are among the comparability criteria for the arm's-length analysis of related-party loans in Clause 11 of Article 105.5 of the RTC. In practice, this is often interpreted as a preference for a stand-alone credit rating.

When a borrower has an official credit rating assigned by an international or national credit rating agency, the Russian tax authorities give preference to these official credit ratings. Generally, when establishing the credit rating of the borrower, the methodology of these rating agencies assumes the importance of the passive association of an entity within a group. This may give an indirect indication that the Russian tax authorities will consider the passive association as well.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

In a situation where the Russian tax authorities have not issued formal guidance or recommendations and relevant court practice is silent on the issue, both the economic circumstances and contractual terms and conditions of the related-party loan may be taken into account in evaluating the borrower's creditworthiness.

In most cases, the following factors may be taken into account when evaluating the borrower's creditworthiness, in particular:

- geographic location of the borrower's main business activities and the sovereign rating of the country;
- industry of the borrower; and
- financial performance and the scale of business of the borrower.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking a related-party loan analysis?

The following databases are among those utilized when undertaking a related-party loan analysis in Russia:

- Russian databases: CLoans, CBonds and RusBonds and
- International databases: Thomson Reuters, LoanConnector and Bloomberg.

Typically, if a borrower is located in Russia and the related-party loan is issued in Russian rubles, a starting point for the analysis is to search the Russian databases in order to identify comparable loans and bonds issued in Russian rubles and (or) with similar tenors. However, in most cases, it is very difficult to identify comparable transactions on the Russian and CIS markets, and search strategies are often broadened to identify comparable transactions executed in the foreign markets with comparability adjustments to account for differences in currencies as well as markets, i.e. the country premium adjustment.

In short, it is very rare that Russian databases are the only source used and referenced in transfer pricing documentation reports when undertaking a related-party loan analysis. Nevertheless, proof that the Russian databases have been researched and did not provide comparable transactions has been identified as a solid argument for the use of the international databases.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

Effective January 1, 2015, clause 1 Article 269 of the RTC provides "safe harbor" ranges. For inter-company transactions recognized as controlled under TP rules, safe harbor ranges should be taken into account in determining the defendable interest rates (both income and expenses) for income tax purposes.

The safe harbor provisions apply as follows:

- The lender has the right to recognize the actual interest on the debt as income if the rate exceeds the lowest value of the safe harbor range; and
- The borrower has the right to recognize the actual interest on the debt obligation as an expense if the rate is lower than the highest value of this same the safe harbor range.

Currency of debt	**Lowest value**	**Highest value**
Rubles	75% of the key rate of the Central Bank of Russia	125% of the key rate of the Central Bank of Russia
Euro	EURIBOR + 4%	EURIBOR + 7%
Chinese yuan	SHIBOR + 4%	SHIBOR + 7%
Pounds sterling	LIBOR + 4%	LIBOR + 7%
Swiss francs	LIBOR + 2%	LIBOR + 5%
Japanese yen	LIBOR + 2%	LIBOR + 5%
Others (including US dollar)	LIBOR + 4%	LIBOR + 7%

In all other cases involving controlled transactions, the arm's-length nature of the actual interest recognized as income or expenses on the debt has to be established under the TP rules.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

In Russia, it is a rare situation to see negative interest rates in the context of deposits and related-party loans. This is generally observed in euro based cash-pool financing transactions where a Russian subsidiary places euro or ruble deposits with the cash-pool leader under inter-company loan agreements with negative spreads over the base rates of Euribor or MosPrime.

Under the Russian civil law, a Russian company may only place a deposit within a bank which has a special license obtained for undertaking deposit operations. This transaction will be executed under the deposit and not a loan agreement. Therefore, from the Russian tax and TP perspectives, deposit transactions under cash-pooling arrangements are characterized as loans executed under a loan agreement and not deposit arrangements.

Based on the above, the approach to establish arm's-length ranges of negative spreads over the base rates is the same as the approach applied to related-party loans with positive interest rates and spreads where all necessary criteria shall be taken into account.

Furthermore, on 14 September 2016 the 13th Appellate Arbitration Court of Saint-Petersburg under the resolution [1] 13ÀÏ-19554/2016 of court case [1] À56-1007/2016 ruled that loan agreements cannot be considered comparable to bank deposits. Hence, when analyzing arm's-length nature of negative interest rates for related-party loans, loan transactions should be applied as comparables.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

The Russian tax authorities are increasingly focusing on validity of application of lower tax rates under Russian double tax treaties. Both tax authorities and courts adhere to facts-and-circumstances and substance-over-form approaches, performing a thorough case-by-case analysis of intra-company cross-border transactions.

Currently there are more and more court cases where the Russian tax authorities successfully challenged reduced tax rates and exemptions using beneficial ownership concept for intra-group lending arrangements.

Thus, Russian taxpayers setting up intra-group lending arrangements must take into account not only the arm's-length nature of interest rates applied but also beneficial ownership and tax residence concepts, ensuring the transactions are commercially rational and have a legitimate business purpose.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

As mentioned above, court practice in Russia follows the substance-over-form approach. Hence, in a majority of court cases, the tax authorities have successfully challenged the economic substance of transactions and, in several cases, have reclassified the type of transaction (debt into equity).

The RTC has no special provisions regarding the hybrid mismatch arrangements. However, as mentioned-above, recently introduced GAAR provisions under the Article 54.1 of the RTC allow tax authorities to reclassify the substance of a transaction if the main purpose is only to receive tax benefits. Ultimately, the transactions must not be tax driven, otherwise it will not be recognized for the taxation purposes.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

According to the clause 9 of Article 307 of the RTC, when the entrepreneurial activities of a foreign organization in the territory of the Russian Federation give rise to a permanent establishment (PE) in Russia, the income of the permanent establishment which is taxable in Russia is determined by taking into account functions performed, assets used, and economic (commercial) risks assumed in Russia. Based on this provision, Russian taxpayers apply a separate entity approach when calculating the income of Russian PEs.

For outbound transactions, the arm's-length nature of interest on cross-border loans issued by Russian PEs is established using an approach similar to the one applied for related-party loans between two legal entities mentioned in the preceding paragraph.

For inbound loans, since a Russian PE will not have its own credit profile, its creditworthiness may need to be assessed on its own credit profile allocating relevant assets and capital, and not on the credit profile of its parent company.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Similar to the related-party loans, the arm's-length nature of a guarantee charge has to be assessed, for Russian tax purposes, based on an internal and external CUP analysis, using comparable transactions available in the databases, e.g., guarantees, letters of credit, as well as CDS as priority comparable instruments followed, by the expected benefit and loss given default approaches.

If a related-party loan provided to a Russian borrower is guaranteed by a foreign affiliate, an arm's-length analysis of the interest rate on the loan must account for the availability of the guarantee. Under these circumstances, the analysis must take the credit profile of the guarantor into consideration, effectively ensuring that the availability of the guarantee adjusts the interest rate as if it were applied without provision of the explicit loan guarantee. In that case, a separate remuneration for the provision of the explicit loan guarantee must also be paid by the Russian borrower.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

There is a two-step process that Russian tax authorities use to determine if a taxpayer is subject to an interest deduction limitation arising in connection with a related-party loan. First, the arm's length nature of the interest rate on inbound related-party loans should be assessed, and then the debt-to-equity ratio is applied to determine the characterization of any excess interest.

Clause 2 Article 269 of the RTC covering the Russian thin capitalization rules restricts deductibility of interest on related-party loans provided to Russian borrowers that exceed the acceptable debt-to-equity ratio, which is generally 3:1 but 12.5:1 for banks and leasing companies. Interest on debt in excess of the established ratios is nondeductible and treated as a dividend paid to a lender, subject to dividend taxation.

The limitation of the thin capitalization rules is applied after the transfer pricing analysis of related-party loans.

Evgenia Veter is a Partner and Head of Transfer Pricing and Operating Model Effectiveness in the CIS, Yuriy Mikhailov is a Senior Manager in the Financial Services Transfer Pricing group, and Timur Akhmetzianov, Senior in the Financial Services Transfer Pricing group, at EY Moscow. They may be reached at:

evgenia.veter@ru.ey.com

Yuriy.Mikhailov@ru.ey.com

Timur.Akhmetzianov@ru.ey.com

www.ey.com/RU/en/

Singapore

Peter Tan and Michael Nixon
Baker & McKenzie.Wong & Leow, Singapore

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The Inland Revenue Authority of Singapore ("IRAS") views the Comparable Uncontrolled Price Method ("CUP") as the most appropriate transfer pricing method to evaluate the arm's length nature of interest charged on a related-party loan; however, if circumstances render another method to be more appropriate, taxpayers can apply that method. In most situations, the CUP approach is expected to be applied.

Determination of the arm's length rate of interest would first entail evaluating comparability between the actual lending transaction and potential external or internal comparables, using the comparability factors outlined in Paragraph 13.13 of the 5th Edition of the Singapore Transfer Pricing Guidelines ("the Guidelines").

Once appropriate comparable transactions are identified, the arm's length interest rate can be quantified using those comparables. If CUPs are available to determine the interest rate but they are not entirely comparable to the tested related party loan, comparability adjustments can be made to eliminate the differences.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

From a transfer pricing perspective, the arm's length standard is applied in most circumstances to assess the deductibility of interest in Singapore or the taxable interest to be assessed in Singapore with regard to lending arrangements, the only exception being when a taxpayer in Singapore lends to or borrows from a related party in Singapore. In the case of such a related party domestic loan provided by a taxpayer which is not in the business of borrowing and lending, IRAS will apply an interest restriction in place of the arm's length methodology. This is done by limiting the taxpayer's claim for interest expense to the interest charged on such loan.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

Where independent parties in comparable circumstances would enter into substantially different commercial or financial relations than those between the taxpayer and its related party, IRAS will determine the arm's length price for the related-party transaction based on the commercial or financial relations independent parties would enter into. IRAS broadly follows the standards promulgated in the OECD's 2017 Transfer Pricing Guidelines in evaluating whether a loan would in fact be made by third parties in the specific circumstances in which the loan arose, and in its particular form.

IRAS recognizes that related parties may have the ability to enter into a much greater variety of arrangements than independent parties. Related parties may also conclude transactions of a specific nature that are not encountered, or very rarely encountered, between independent parties. They may have done so for sound business reasons. Therefore, where a taxpayer engages in a transaction with its related party that independent parties would not undertake, IRAS would not disregard the transaction merely because the

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transaction may not be seen between independent parties without considering if the transaction has characteristics of an arm's length arrangement.

IRAS would disregard an actual related party transaction or replace it with an alternative transaction only in exceptional circumstances where: (a) the arrangements made in relation to the transaction lack the commercial rationality that would be agreed between independent parties under comparable circumstances; and (b) the arrangements prevent determination of a price that would be acceptable to both parties taking into account their respective perspectives and the options realistically available to them at the time the transaction is entered into.

When the actual related party transaction is replaced with an alternative transaction, the replacement structure should be guided by the facts of the actual transaction so as to achieve a commercially rational result that is in accordance with the arm's length principle.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

There is no specific guidance on the issue of how the potential benefits provided by passive affiliation with its group should be factored in to the transfer pricing analysis of the arm's length interest rate. IRAS broadly follows the standards promulgated in the OECD's 2017 Transfer Pricing Guidelines in evaluating such matters.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

As the interest rate earned compensates the lender in part for bearing the credit risk of the borrower defaulting on the loan, the pricing of interest rates can be determined by reference to the credit rating of the borrower. IRAS would typically expect the credit rating of the borrower to be estimated using commercial credit scoring software provided by credit rating agencies based on information available at the time the related-party loans are obtained. This information is predominantly quantitative in nature, but IRAS may accept further quantitative or qualitative information to help assess the credit worthiness of the borrower, depending on the facts and circumstances of the particular transaction.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

IRAS would accept loan information obtained from the various commercial databases available on the open market.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

To facilitate but also ease compliance with the arm's length principle in certain circumstances, IRAS has put in place an "indicative margin" which taxpayers can apply on their related-party loans obtained or provided from January 1, 2017. The indicative margin is published on IRAS' website and is updated at the beginning of each year. Applying the indicative margin is not mandatory, and taxpayers may adopt a margin that is different from the indicative margin provided that it is consistent with the guidance provided in the Guidelines to determine arm's length interest rates.

Taxpayers can choose to apply the indicative margin to each related-party loan that does not exceed S$15 million at the time the loan is obtained or provided. The threshold is based on the loan committed and not the loan utilized. The indicative margin is applicable to both Singapore-dollar denominated and foreign currency denominated related-party loans. For related-party loans denominated in foreign currencies, the threshold (in Singapore dollars) is to be determined based on the prevailing exchange rate at the time the loans are obtained or provided.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

The interest rates consisting of a base rate and a margin or a fixed interest rate, should be determined based on transactions comparable to the transaction being tested in the transfer pricing analysis. If the base interest rates (e.g., EURIBOR, SIBOR, LIBOR, etc.) are currently negative in comparable third-party situations, then this should not be specifically challenged as part of the transfer pricing analysis, if the base itself is appropriate.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

No recent changes have been made to Singapore's income tax rules specific to the determination of an arm's length interest rate on related-party transactions. IRAS released guidance on the Income Tax Treatment of Hybrid Instruments on May 19, 2014.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

For purposes of attributing profits to a permanent establishment, where a non-resident person carries on a business through a permanent establishment in Singapore: (a) the permanent establishment in Singapore of that person; and (b) other permanent establishments outside Singapore of that person, are treated as separate and distinct persons. They are considered related parties, and accordingly, the arm's length principle applies when attributing profits to the permanent establishment in Singapore. Capital would likely be deemed to be provided to the distinct and separate persons based on their capital expenditure and operating needs and any related-party interest attributable on such loans would likely be based on the credit rating of the entity as a whole.

Note that, if the following conditions are met, there will be no further attribution of profits to a Singapore PE and thus, there will be no additional Singapore tax liability for the foreign related party: (a) the taxpayer receives an arm's length remuneration from its foreign related party that is commensurate with the functions performed, assets used and risks assumed by the taxpayer; (b) the remuneration paid by the foreign related party to the taxpayer is supported by adequate transfer pricing documentation to demonstrate compliance with the arm's length principle; and (c) the foreign related party does not perform any functions, use any assets or assume any risks in Singapore, other than those arising from the activities carried out by the taxpayer.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

IRAS provides no specific guidance in this respect. IRAS would expect that a guarantee fee be accounted for when charged under arm's length circumstances and at an arm's length rate, taking into account the various comparability factors (including the value of implicit support in this respect, although this is yet to be tested in court). If a guarantee is provided to a third-party lender on behalf of a borrower by an affiliate, a separate guarantee fee would need to be accounted for.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

To date, Singapore has not applied such restrictions based on BEPS Action 4. Nor does it have thin capitalization rules.

Peter Tan is a Senior Consultant (Tax and Transfer Pricing), and Michael Nixon is Director of Economics, Transfer Pricing, both are with Baker & McKenzie Wong & Leow, Singapore. They may be contacted at:

peter.tan@bakermckenzie.com

michael.nixon@bakermckenzie.com

http://www.bakermckenzie.com/en/locations/asia-pacific/singapore

Spain

Elisenda Monforte, Airam Gonzalez, Daniel Ruiz, and Daniel Bourdages
KPMG, Spain

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related-party loans? What methods does it specify - or which does it permit if it does not specify methods - (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

The Spanish transfer pricing regulations do not include specific guidance for the analysis of financial transactions; they only outline the general framework and transfer pricing methods applicable to the analysis of intercompany transactions. In this respect, the Spanish transfer pricing regulations allow for the use of any of the five transfer pricing methods defined in the OECD Guidelines.

The new Spanish Corporate Income Tax Law[1] eliminated the hierarchy of transfer pricing methods and aligned with the "best method" approach. In line with the OECD guidelines, the Spanish regulations now require the selection of the most appropriate transfer pricing method, considering the nature, terms and circumstances of the transactions, which collectively are the essence of the comparability analysis, as well as the availability of reliable information to apply the method.

Based on the above, Spanish taxpayers typically apply the CUP method when establishing the arm's-length terms and conditions of controlled financial transactions. If the taxpayer, or any of its related parties, is involved in financial transactions with third parties, the applicability of the CUP method based on internal comparables should first be analyzed. The existence of potential internal comparables should be carefully analysed either to accept the third-party instrument as a comparable uncontrolled transaction or to document why it is deemed not comparable after performing a comparability analysis. Spanish tax authorities will often rely on internal comparables. Hence, the existence of third-party transactions requires a close analysis when they are not considered comparable.

In some instances, an affiliate may on-lend the funds obtained from a third-party loan or other debt instruments (bonds, debentures, etc.). Taxpayers sometimes rely on the costs of third-party funding to establish the interest on intercompany transactions. This approach requires careful consideration, as it may not reflect the arm's-length interest rate of the controlled loan.

Some characteristics that should be considered when establishing the arm's-length terms and conditions of a controlled financial transaction include the purpose of the funding, the debt to equity ratio of the borrower, the expected interest coverage ratio, the existence of guarantees, the subordination level of the financial instrument, the term and the currency, among others.

When reliable internal comparables are not available, it is common practice for both taxpayers and tax authorities to rely on external comparables. Given the liquidity of the financial markets, it is relatively simple to identify sufficient comparable independent financial transactions to allow the application of the CUP method based on external comparables. In this respect, there are databases that provide information regarding the contractual conditions on financial transactions in the capital markets.

The information provided by specialized databases such as Bloomberg®, Thomson Reuters Eikon® or LoanConnector® mainly consist of bond trading information and key terms of relevant syndicated loans. By nature, the listed bonds or the syndicated loans may differ from intercompany funding transactions in terms of principal, liquidity and purpose, among other factors. However, given that this is the most accurate information available for both taxpayers and tax inspectors, the use of information provided by financial databases is commonly accepted by the Spanish tax administration.

Notwithstanding all the above, Spanish taxpayers must be ready to address the characterization of the instrument (i.e., debt vs equity), especially if they are the borrower in controlled financial transactions. In that case, the first challenge from the tax auditors will revolve around the characterization of the transaction and, ultimately, the deductibility of the financial expenses. It is critical to have support for the loan's purpose and the borrower's expected capacity to repay the debt at maturity.

The Spanish tax inspectors do not tend to propose new searches for comparable financial transactions when trying to determine the arm's-length interest rate and conditions. However, they often will challenge the set of comparable financial instruments presented by the taxpayer. Hence, it is strongly recommended to have a robust set of comparable financial instruments which support the arm's-length character of the controlled financial transaction under analysis.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

As the Spanish transfer pricing regulations do not establish a specific framework for the analysis of intercompany financial transactions, the approach of the transfer pricing analysis does not differ for outbound and inbound transactions. However, what may be different is the pressure of the tax authorities depending on the position of the Spanish taxpayer.

When the borrower of the intercompany funding is based in Spain, the Spanish tax administration may challenge the deductibility of interest expenses and the nature of the transaction. It may be much more difficult to defend the characterization of the debt when the purpose of the funding is not clear or the repayment capacity of the borrower is uncertain. Hence, as in other jurisdictions, the taxpayer should assess the "would" test: Would a third party issue the loan under the same terms and conditions?

On the other hand, Spanish tax authorities may question the nature of the flows when the Spanish taxpayers deposit funds abroad. One of the key differences between intercompany loans and deposits is the availability of the funds. The intercompany loans are usually granted for a specific purpose, and the lender cannot call for the reimbursement of the funds before the maturity date (unless there is an embedded option). On the other hand, intercompany deposits are used when the lender wants to cede its cash surpluses and earn a return. In the case of intercompany deposits, the funds shall be available for the depositor.

The opportunity cost and the credit risk borne by the lender are higher when granting an intercompany loan, and this is also true among third parties. Hence, this leads the Spanish tax administration to analyse in detail the terms and conditions agreed on intercompany funding, as well as the economic reality behind the transactions.

Based on all of the above, it is crucial to perform an in-depth analysis of the terms, conditions and circumstances surrounding the controlled financial transaction under analysis, as each of the factors introduced above and explained in the following section may have a direct impact on both the characterization and the conditions of the financial instrument.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt?

A wide range of factors are taken into consideration by the Spanish tax authorities to assess the characterization of the instrument (i.e., debt vs equity). Some of the most relevant factors might be the principal, tranche structure and costs of funding for the lender. For instance, if an entity centrally manages the Group's funding and negotiates a syndicated third-party loan, the interest rate agreed with the financial institutions might often be considered a floor by tax authorities.

Other aspects can be considered relevant. For example, the Spanish tax administration made adjustments to a series of loans granted by a Spanish entity of the McDonald's Group during 2000 and 2004 after considering different aspects, such as, the issuing entity had no structure or means to grant the loan and monitor compliance with its conditions, the lender did not have funds to lend (instead, it lent them-after borrowing them from other affiliates), and prepaid a loan received by the parent company at 0% interest rate to receive another with an interest rate of 3.3%.[2]

i. Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee?

While doing so may be helpful, from a Spanish transfer pricing perspective it is not necessary to prove that a loan would have been made by an unrelated lender. Instead, the entity has to justify the reasonableness of the interest rate and other contractual terms (e.g., guarantee).

ii. Is there a separate consideration of whether the "borrowing" is in fact an equity infusion?

Before 2012, Spain had a thin capitalization rule. However, since 2012, this rule has been replaced by new earnings stripping rules, discussed in response to question 7, and the Spanish tax administration evaluates the equity nature of a borrowing based on a facts and circumstances approach. .

There is not a particular feature that the Spanish tax administration considers when determining if a borrowing is a loan or an equity infusion. Instead, all the terms of the borrowing as well as qualitative aspects are considered.

iii. What happens if the loan is interest-free, and what happens if there is no written agreement?

If a loan is interest-free, the Spanish tax administration will tend to re-characterize it as equity. Issuing interest-free outbound loans from a Spanish entity will likely result in the re-characterization of the loan as equity and an adjustment in the revenue of the Spanish entity.

A written agreement is not mandatory from a civil law perspective, but it provides evidence of the instrument's terms and conditions and mitigates the risk of having the Spanish tax authorities define the terms on the basis of the observed conduct of the parties.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

The Spanish tax administration always evaluates the borrower as a stand-alone entity. Also, following the criteria established in the OECD Guidelines, the Spanish tax administration would not typically consider that an affiliate is receiving an intra-group service when it obtains incidental benefits attributable to being part of a larger group.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

A wide range of qualitative aspects can be considered by the Spanish tax administration in the evaluation of a borrower's creditworthiness. Some of them might be the relative competitive position of the entity in the local market, its leverage, country risk and industry trends.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

For information about comparable loans, Loan Connector is the source of data commonly referenced. Eikon and Bloomberg are also commonly referenced to find bond comparables.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

There are no safe-harbor rates in the Spanish regulations nor in guidance provided by the Spanish tax authorities.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

Base rates on loans or deposits may be negative to the extent that the taxpayer may prove that there are comparable third party arrangements with a similar price. In Spain, contracts establishing the terms of financial operations typically include clauses establishing interest floors above zero percent.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Limits in tax deductibility of net interest expense are one of the main issues related to intra-group lending activities. This topic is further discussed in question 7.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

As a result of the BEPS Action 2, the Spanish tax Law developed different rules that took effect from 2015. One of them is the anti-hybrid debt instruments rule, whereby interest expenses accrued on hybrid instruments is not deductible when the income is not taxed or taxed at a rate lower than 10% at the level of the lender.

In relation to the treatment of hybrid instruments, the tax treatment of the Spanish tax administration of the Brazilian concept of interest on net equity (*juros sobre o capital proprio* or "juros") has been controversial in Spain. Despite the tax deductibility of juros, there is ample consensus in Brazil that this financial instrument is a form of return to shareholders, bearing no resemblance to interest deriving from debt. Even before the BEPS project, the Spanish tax administration was never receptive to this characterization, so taxpayer arbitrage in relation to juros was not uncommon. The Spanish tax administration favoured the view that the hybrid nature of juros was such as to warrant its treatment as debt and, therefore, as giving rise to fully taxable income in Spain. From 2015, the Spanish participation exemption regime contains a specific limitation for dividends that have been deducted in the home jurisdiction of the payee. Thus, regardless of its characterization in Spain, juros would no longer benefit from the participation exemption.

Additionally, since 2015 interest expenses on intra-group profit participating loans are not deductible.

5. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

Spain's legislation with respect to guarantee fees follows the OECD's guidance. As such, a Spanish-tax resident is expected to pay a guarantee fee to its foreign affiliate for providing an express guarantee.

In Spain, form holds significant weight relative to substance. The Spanish tax administration typically challenges transfer pricing arrangements on a very formalistic basis, sometimes choosing to contest the legal terms before the underlying conditions. Thus, the importance of a well-defined contractual agreement—in this case, clearly outlining the explicit guarantee—cannot be understated. For this reason, a separate guarantee transaction might be preferable as opposed to a blended, all-inclusive interest rate-and-guarantee fee transaction.

In Spain, guarantee fees are priced according to conventional pricing methods, including, but not limited to, the comparable uncontrolled price method, the yield approach (i.e., looking at the spread in corporate bond yields between the guarantor's credit rating and the estimated credit rating of the guarantee) and credit default swap benchmarking. There is no Spanish case law relevant to the pricing of intercompany explicit guarantees, nor are there any relevant mentions in the domestic law. Thus, we typically prioritize the methods and hierarchy established in the OECD Guidelines—in this case, a preference for the comparable uncontrolled price method.

The Spanish tax administration does not typically focus its audit efforts on intercompany explicit guarantee transactions. However, if the question does arise, the counterparties usually come to an agreement through negotiation, thus avoiding formal reassessments.

6. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

Spanish permanent establishments are expected to satisfy the capital structure requirements established in the OECD's guidance on the attribution of profits—that is, the capital structures of permanent establishments require a certain amount of funding made up of "free" capital and interest bearing debt. The Spanish tax administration has addressed debt financing in the context of permanent establishments—specifically, the ING case.[3]

For the financial years 2002 and 2003, the Tax Authority recharacterized a part of the interest-bearing debt of ING's Spanish branch as "free" capital, with the consequent reduction of the tax-deductible expenses for debt interest. This was done on the basis of a dynamic interpretation of Article 7 of the applicable tax treaty, which deals with the issue of the attribution of profits to permanent establishments. In other words, the Tax Authority recharacterized ING's transaction by retroactively applying recently passed OECD guidance and commentaries. The Supreme Court of Spain, however, disagreed with the dynamic interpretation. It argued that, in relation to "free" capital, significant amendments had been introduced into the Commentaries on Article 7 of the OECD Model Convention of 2008 and into the OECD Report of 2006 on "Attribution of profits to permanent establishments". Thus, in Spain, OECD commentaries and guidance apply to past tax treaty articles to the extent that they do not significantly distort the meaning of the articles.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Effective January 1, 2012, Spain replaced its thin capitalization regulations with a new set of earnings stripping rules. As such, a Spanish tax resident's net interest expenses are deductible up to a limit of 30 percent of the EBITDA of the tax period (consolidated EBITDA in the case of a tax group). Certain types of interest expenses are deemed non-deductible prior to applying the EBITDA threshold; they are,

- Interest paid to individuals or entities resident in low tax jurisdictions, unless it can be proved that there are *bona fide* business reasons behind the transactions.
- Interest paid to related parties which are taxed in the hands of the beneficiary at a nominal tax rate lower than 10 percent.
- Interest paid to other group companies for loans used to finance the acquisition of companies pertaining to the same group. In other words, internal loans linked to intra-group reorganizations.

In the event that the net interest expenses for the tax period do not reach the 30 percent threshold, the difference between the threshold amount and net interest expenses for the tax period shall be added to the limit of the tax periods ending in the five subsequent years, until the difference is deducted. Moreover, the earnings stripping rules will not apply if the net interest expenses do not exceed EUR 1 million. These rules apply to interest on both related and third-party debt.

Hence, since January 2012, Spain has operated a system of interest deduction limits in line with that of the OECD's proposed Action Plan 4—specifically, the fixed ratio rule. The OECD recommends a system whereby an entity's interest deductions are capped at a fixed ratio established by the country's tax authority. In other words, if the stand-alone entity's net interest expense is greater than its EBITDA multiplied by the fixed ratio rule, the interest deductions are deemed too excessive. Accordingly, the tax authority would revise the net interest expense to the maximum allowable value (i.e., fixed ratio multiplied by the EBITDA) and reject any outstanding interest amounts. In Spain's case, the fixed ratio is set to 30 percent of EBITDA.

Spain also applies special limitations on the interest deductions arising from a leveraged acquisition—or, acquisitions where the acquisition price is financed by at least 70 percent debt. Net interest expenses derived from loans granted to purchase an equity interest of any entity are limited to 30 percent of the operating profit of the target company.

Elisenda Monforte a partner of KPMG in Spain and leads the

EMA Financial Services - Global Transfer Pricing Services practices. Airam Gonzalez, Daniel Ruiz and Daniel Bourdages are senior associates of KPMG in Spain. They can be contacted at:
emonforte@kpmg.es
danielruiz2@kpmg.es
danielbourdages@kpmg.es
airamgonzalez@kpmg.es
https://home.kpmg.com/es/es/home.html

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[1] Approved on November 27, 2014.

[2] Source: Court ruling of the Spanish Supreme Court 961/ 2017.

[3] Audiencia Nacional, case number: 182/2012

Switzerland

David McDonald, Ian Clarke, and Jean-Baptiste Massat
PWC, Switzerland

1. Does your country specify permissible methods for evaluating an arm's length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Generally, Swiss law provides a legal basis for transfer pricing adjustments on transactions that are not at arm's length; however, Swiss legislation does not contain specific transfer pricing provisions.[1] Therefore, there are no express statutory provisions requiring the use of a specific transfer pricing method to evaluate the interest on related-party loans, but the Swiss Federal Tax Authority (SFTA) has issued a circular expressly directing tax authorities to take the OECD Guidelines into account.[2] The use of CUPs (either internal or external) is most commonly accepted by the Swiss Tax Authorities.

Nonetheless, the arm's-length nature of interest on a related-party loan is typically not challenged if the rate is within the minimum and maximum safe harbor interest rates, which are established annually based upon the prevailing interest rates in the Swiss and foreign currency markets. The SFTA annually publishes the safe harbor maximum and minimum interest rates to be applied to intra-group loans both in Swiss Francs[3] and in foreign currencies.[4]

When "safe harbor" rates Do tax authorities ever seek to recharaterize a loan as an equity infusion if the interest rates are within the safe harbor limits, but the recipient has high debt compared to equity?

do not accurately reflect the economic circumstances surrounding an intercompany transaction, taxpayers may depart from the safe harbor interest rates as long as that the arm's-length nature of the transaction is established and documented.

For related-party loans expressed in foreign currencies, taxpayers should document reasons why the loan is not in Swiss Francs at a lower interest rate. In these circumstances, tax authorities may require the borrower to demonstrate that there is a commercially justifiable reason why the loan was not agreed upon at the lower Swiss rate.

Consideration of the arm's length interest rate should also take into account the arm's length nature of the capital structure of the borrower.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

There is no difference in the method for inbound or outbound transactions; however, note the point on safe harbor rate outcomes above.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

Although Switzerland has not enacted legislation providing for Transfer Pricing documentation requirements, Swiss Tax Authorities expect taxpayers to demonstrate the commercial rationale for an intragroup transactions during audits. This could include explanation of the business purpose for the lending, together with supporting financials, or comparison of the resulting capital structure to norms within the industry.

With regard to loan agreements, a reasonable level of flexibility is possible in the event of no agreement being in place, with an emphasis on the conduct of the parties.

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b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's length standard or as a necessary interpretation of it, or something else?

There is no specific guidance or formal position on implicit guarantees; however, the general practice in Switzerland is to evaluate the borrower as a stand-alone borrower.

We have not seen extensive consideration of implicit support and it would not be viewed as a necessary interpretation.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

A borrower's credit worthiness can be established using different practices, but this determination relies heavily on the specific circumstances of each transaction. Acceptable approaches include the use of the Parent credit rating, the application of a notch up or down from the Parent credit rating, the comparison of S&P or Moody's ratios to the borrower's ratio, or the use of other credit scoring tool.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Data extracted from publicly available commercial data (Bloomberg, Thomson Reuters' LoanConnector) bases are accepted by the Swiss Tax Authorities to support an intercompany loan analysis. Internal CUPs are the preferred data for analyzing intercompany loan provided that they present sufficient comparability.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

As referenced above, SFTA publishes minimum and maximum safe harbor interest rates on both on Swiss Francs and foreign currency loans on an annual basis.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

Negative interest is usually dealt with by applying a base rate equal to zero for the purpose of determining the remuneration of deposits.

g. Does intra-group lending present other issues under your country's tax system, and how are those dealt with by taxpayers?

Not applicable.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

Switzerland is not contemplating the introduction of additional legislation regarding hybrid structures.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

The Swiss Federal and Cantonal Tax Authorities follow the OECD approach, including the guidelines provided by the 2010 Report on the Attribution of Profits to Permanent Establishments.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

There is no specific guidance or formal position on guarantees. However, the general expectation would be that an "interest saved" approach would be applied.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

Not applicable.

David McDonald is a Financial Services Transfer Pricing Partner in PwC Switzerland and PwC Europe; Ian Clarke is a Director in the Transfer Pricing and Value Chain Transformation Team in Geneva, Switzerland; and Jean-Baptiste Massat is a Consultant in the Transfer Pricing and Value Chain Transformation Team in Zurich.

They may be contacted at:

mcdonald.david@ch.pwc.com;

ian.clarke@ch.pwc.com;

jean.baptiste.massat@ch.pwc.com;

http://www.pwc.ch/en.html

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[1] Article 58 of the Federal Law on Direct Federal Tax of December, 14 1990 (LIFD; RS 642.11) and Article 24 of the Federal Law on the Harmonization of the Cantonal and Communal Taxes of December 14, 1990 (LHID; RS 642.14) lay the legal grounds for adjusting profits on an arm's length basis.

[2] Swiss Federal Tax Administration, Circular of March 4, 1997, replaced by Swiss Federal Tax Administration, Circular n°4, March 19th, 2004, 1-004-DV-2004-e.

[3] Lettre circulaire sur les Taux d'intérêt 2018 admis fiscalement sur les avances ou les prêts en francs suisses, 2-159-DV-2018-f, February 19. 2018

[4] Lettre circulaire sur les Taux d'intérêt 2018 admis fiscalement sur les avances ou les prêts en monnaies étrangères, 2-160-DV-2018-f, February 20,2018

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United Kingdom

Murray Clayson and Xander Friedlaender
Freshfields Bruckhaus Deringer LLP

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

Under the UK transfer pricing regime, a UK company that lends money to or borrows money (including on interest-free terms[1]) from a company meeting the participation condition[2] (i.e. the statutory test of common control) may be subject to transfer pricing adjustments if the loan is determined not to be made at "arm's-length."[3] Section 147 Taxation (International and Other Provisions) Act 2010 (TIOPA 2010) sets out the rules for establishing the terms on which a loan would have been made had the parties to the loan been independent enterprises. This follows the OECD approach in Article 9(1) of the OECD Model Tax Convention. In simple terms, the key concept underpinning the arm's-length principle is "comparability." In order to determine whether the arm's-length provision differs from the actual provision made, the two must be compared. The arm's-length principle is applied by replacing the terms on which the loan was actually entered into with arm's-length terms and recalculating the interest.

The UK legislation does not directly specify permissible methods for evaluating arm's-length interest rates, but in effect adopts the five methods specified in the 2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (as revised by the final BEPS Actions 8-10 report) (the TPG) through a provision[4] in TIOPA 2010 requiring key parts of the legislation[5] *"to be read in such a manner as best secures consistency"* with the TPG. The TPG do not currently draw a distinction between the application of the arm's-length principle to loans as compared to other arrangements also subject to transfer pricing. At the time of writing, the OECD's promised work on transfer pricing of financial transactions is awaited.

While the TPG previously established a hierarchy between methods for evaluating arm's-length terms, this was removed in an update in 2010. The TPG now make clear that the selection of a method to establish the arm's-length terms is largely fact dependent and that the method chosen should always be the most appropriate one for the particular set of facts.

Nevertheless, the leading UK case on transfer pricing methods[6] as well as HMRC guidance[7] and the TPG[8] all indicate that while no absolute hierarchy exists within transfer pricing methods the preferred method (if it can be applied) is the comparable uncontrolled price method (CUP). Where no suitable comparator can be found, the next best alternative method should be selected from the five listed in the TPG. Preference is generally shown to traditional methods over the transactional methods.[9]

Given the lack of clarity in the statute and the TPG, it is perhaps not surprising that HMRC guidance on pricing of arm's-length interest rates is generally high level, stating that the interest rate will be determined in reference to *"the currency of the loan, the amount and duration of the loan and the scale, degree and nature of the risks involved"*[10] and that *"the proper interest rate for a transaction clearly depends upon the facts and circumstances of a case."*[11] Nevertheless, in places the guidance is a little more specific suggesting a broad approach based on the terms on which a third party lender would have lent to the borrower. This involves consideration of: the purpose of the loan, existing debt, the security available, expected cash flow, the borrower's credit status, the track record of the borrower and the state of the market. The guidance goes on to state that consideration of a credible comparable controlled price, an existing loan or a definite offer for funding from a third party can be used to determine an appropriate arm's-length interest rate.[12]

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones

As discussed in response to Q1, UK law does not set out an order of preference for the methods of establishing arm's-length terms set out in the TPG. However, as noted in HMRC guidance,[13] the TPG express a preference for traditional methods over transactional ones in cases in which both can be applied in an equally reliable manner. Of the traditional methods a preference is expressed for the CUP method.

While there is no statement in the legislation, the TPG or HMRC guidance indicating a preference for a particular method based on the location of the parties to the transaction HMRC guidance does note that when assessing outbound transactions it may be difficult to look closely at the borrower, so *"focus will naturally be on the UK entity [the lender]."*[14] Further, characteristics of the countries into which the loans are made may be taken into account when applying pricing methods. In an outbound situation, for example, where the country into which the loan is being made is perceived as high risk, the pricing of a loan is likely to be higher than an otherwise similar loan into the UK.

Subject to countryspecific comparability factors, while one would expect to apply the same transfer pricing methods on inbound and outbound transactions, the transfer pricing rules are only able to make adjustments against UK taxpayers (subject to corresponding adjustments where the tax treaty between the UK and the other country has an appropriate provision).[15]

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

It is assumed that the participation condition[16] is satisfied, that the terms of the loan confer a potential advantage[17] in relation to UK taxation to one of the parties to the loan and that the only point in issue is the question of the arm's-length nature of the arrangement.

The agreement entered into between the domestic borrower and foreign affiliate may be formal or informal. If it is a formal written agreement, then an analysis of the terms of that agreement may be relatively straightforward. An unwritten agreement may present more challenges. Nevertheless, HMRC guidance[18] indicates that the absence of a formal agreement is not conclusive evidence of the absence of a loan relationship. The guidance takes a broad view of what constitutes a loan relationship, stating that *"an agreement may be written, verbal or implied, and may amount to no more than a tacit understanding that a lender will not pursue an outstanding sum for an unspecified time."* The guidance goes as far as to say that *"it may be possible to infer the existence of an agreement from the fact of non-pursuit of an outstanding debt."* In any case the focus is clearly on *"what happens in practice"* rather than *"what is written down or discussed."*

The terms of the loan relationship between the foreign affiliate and domestic borrower may take a number of forms that would attract the attention of UK transfer pricing rules.

In the simplest situation, the "pricing" of the loan between the domestic borrower and foreign affiliate may not match the pricing which would have been reached at arm's-length. For example, an interest-free loan may have been made on which interest would have been charged at arm's-length,[19] or conversely, interest might be charged at an excessive rate. In this case the appropriate adjustment would likely be to deem an arm's-length rate of interest.[20]

In a second situation, the financing arrangements may be arm's-length as between the borrower and lender, but a guarantee may have been granted by a third party connected with the borrower (typically another member of the group). It may be determined that the pricing of the guarantee is incorrect since it was not made on arm's-length terms. As in the first example, the appropriate adjustment may be to deem an arm's-length rate for the guarantee.[21]

In a third situation, the amount of the debt taken on by the borrower may be more than a lender would advance at arm's-length. In this case the appropriate adjustment will often be to treat part or all of the loan as having an "equity function," and disallow deductions for the interest on that element of the debt (often referred to as "excessive debt").

In a fourth situation, a guarantee given by a party related to the borrower may allow the borrower to incur more debt than they would on an arm's-length standalone basis. In this case, the borrower could have its deductions for interest disallowed, although if the guarantor is in the UK, it may be able to claim deductions in lieu.[22]

Scenarios three and four describe "thin capitalisation" situations, where there is insufficient (equity) capital in the borrower.

An important general point in thin capitalisation cases is that the right test to apply is what "would" have happened at arm's-length.[23] This is not the same as testing the maximum amount that a borrower "could" have borrowed, which, although *"less subjective,"*[24] is likely to result in less favorable outcomes for HMRC by encompassing a larger range of values that would be deemed to be at arm's-length.

A further important general point is that the borrower's position is assessed on a standalone or separate entity basis. HMRC guidance[25] refers to the *"borrowing unit,"* meaning the borrower and its assets and liabilities, including its own subsidiaries (if it has any). This is an important change from the pre 2004 rules, which allowed a wider UK group to be taken into account. However, in some cases the guidance[26] does indicate a limited preparedness to relax this slightly, for example, in private equity cases where there are borrowings at different levels in the group. The guidance[27] also indicates that some overseas subsidiaries might need to be excluded if in practice their assets or income are not accessible to the borrower.

In practice thin capitalisation issues are frequently addressed by advance agreement with HMRC under an Advance Thin Capitalisation Agreement or "ATCA," HMRC guidance includes a model form of agreement.[28]

The UK's treatment of implicit guarantees is to an extent unclear. The legislation[29] appears to extend the transfer pricing rules to take account of non-binding arrangements provided there is an expectation of performance. As noted above, s.164 creates an obligation to read the legislation and the TPG *"in such a manner as best secures consistency"* between the two. The new TPG guidelines include examples, one of which appears to be based directly on a relevant Canadian case,[30] that take into consideration implicit support in pricing. Further, there are examples of HMRC guidance recognizing the effects that implicit support can have on pricing, with the guidance stating that *"Expectation in such circumstances may count for as much as a legally binding commitment"*[31] and *"It is a matter of weighing up the likelihood of an implicit guarantee being honoured and the effect that would have on the borrowing terms of the borrower."*[32] Recently, the effect of implicit support was recognized in an Australian case[33] (although, on the facts, the effect was minimal). In light of the change in the TPG guidelines and the obligation in s.164, and without wishing to speculate, the UK might be expected to move closer toward the position articulated in the Australian and Canadian cases.

In considering both thin capitalisation and interest rate pricing, the UK does not have any formal safe harbours relating to interest rates or debt-equity ratios. Historically, HMRC had suggested that a debt-equity ratio of 1:1 and interest cover of 3:1 would generally be considered safe. Nevertheless, HMRC has recently reiterated that *"the UK does not operate safe harbours,"*[34] that each case will turn on its own facts, and that the acceptability of the ratio in question could be influenced by averages in the particular industry in which the parties are operating. The industry specific averages may well differ from those traditionally considered as *"safe."*

HMRC has not indicated how it would deal with negative interest rates in the transfer pricing context. In the absence of guidance, it is likely that ordinary OECD pricing methods would apply in determining that arm's-length rate and this could include (provided other comparability aspects are satisfied) benchmarking against market rates even when they are negative.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

The UK introduced Part 6A TIOPA via the Finance Act 2016[35] to implement fully the BEPS Action 2 recommendations. The legislation addresses imported mismatches as well as mismatches involving permanent establishments and applies to payment made on or after January 1, 2017.

The new Part 6A does not alter the existing transfer pricing rules in Part 4 TIOPA 2010, but instead creates a separate set of rules which deal with hybrid situations. While the legislation[36] gives Part 6A priority over the rules relating to interest barriers,[37] it is silent on the interaction between Part 4 and Part 6A. In previous HMRC draft guidance relating to Part 6A, examples indicated that the transfer pricing rules would be applied prior to the rules in Part 6A, in effect applying rules altering the deduction that would potentially fall within Part 6A prior to applying Part 6A itself. The most recent HMRC draft guidance[38] states that transfer pricing rules act *"alongside"* the hybrid mismatch rules and acknowledges that *"the hybrid mismatch rules do not contain a priority order for considering the application of other legislation."*[39]

The effect of Part 6A is that hybrid mismatch outcomes will have the deduction disallowed where the UK is the payer jurisdiction in respect of a deduction/noninclusion mismatch. Where the UK is the payee jurisdiction, and the payer jurisdiction has not disallowed the deduction as described above, the UK will bring the receipt into charge. The new rules also counteract double deductions arising from a company being a hybrid entity or a dual resident in various circumstances.

Since the effects of Part 6A described in the previous paragraph are in essence to deny deductions in hybrid mismatch situations, the interaction of the provisions with the transfer pricing rules may be of limited value since the consequence of falling within Part 6A is generally that the deduction is denied. If transfer pricing applies prior to Part 6A and reduces the available deduction, this will have little effect on the final outcome if the deduction is to be denied in any case by Part 6A.

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

A non-UK resident company trading in the UK through a PE will have those profits attributable to the PE subject to corporation tax. Profits are attributed to the PE using the "separate enterprise principle," which states that those profits that the PE would have made had it been a separate distinct enterprise that engaged in the same or similar activities under the same or similar conditions as the PE, and dealt wholly independently with the non-UK resident company, are to be attributed to the PE.[40]

The separate enterprise principle is not dissimilar to the "arm's-length principle" in transfer pricing, and HMRC and OECD guidance relating to the arm's-length principle may be used for the most part to assist with the application of the separate enterprise principle.

PEs are able to claim deductions for their general borrowing costs, but since the amount of the deduction is determined by reference to the separate enterprise principle, its amount may be restricted. The separate enterprise principle requires that in calculating the profits attributable to the PE, the following assumptions, referred to as the "capital attribution rule,"[41] are made:

1. the PE has the same credit rating as the non-UK resident company as a whole; and
2. the PE has the same equity and loan capital it would have if it were a separate entity.

The application of the capital attribution rule by HMRC[42] differs somewhat between financial and non-financial businesses. Nevertheless, the underlying purpose of both approaches is to determine the amount of equity and loan capital the PE would have if it were a separate entity and to use this information to calculate the cost of the loan capital. The effect of the rule is *"therefore to apply a limit to the amount of* *interest than can be deducted in the CT [Corporation Tax] computation of a PE."*[43]

HMRC guidance[44] makes clear that *"it is only necessary to consider the attribution of capital to a PE if interest is claimed as a deduction in the computation of PE profits."* Nevertheless, where debt and interest costs are attributed to the PE making it necessary to attribute capital also, HMRC *"use thin capitalisation transfer pricing principles to determine the amount of any computational adjustments."*

The profit attribution rules relating to PEs are therefore distinct from the transfer pricing rules, but operate on similar principles and in a comparable manner to reach outcomes that are not dissimilar to those of the transfer pricing regime.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

If it is assumed here that a UK company borrows from a third party ýand that borrowing is supported by a guarantee issued by the UK company's foreign affiliate, there is no binding obligation upon the UK company to account for a guarantee fee (expense) under UK transfer pricing rules. On the other hand, if a guarantee fee is charged, this must not exceed an arm's-length price.

As regards the transfer pricing (including thin capitalisation) treatment of the debt itself, a guarantee from a related person is to be disregarded (so that the borrower is treated as a separate entity) in determining the appropriate level of the borrower's indebtedness, whether it might be expected that the borrower and any person would have become parties to the debt, and the interest rate and other terms of the loan.[45] This approach operates as a precursor to working out whether a guarantee has an arm's-length value to the borrower.[46]

Where a foreign affiliate provides a loan guarantee to a UK borrower, the terms of the loan and the guarantee will be subject to the transfer pricing rules regardless of whether the lender is affiliated with the borrower or not.[47] It should be noted that "Guarantee" is very widely defined as *". . .a surety and. . .any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by the issuing company he will be paid by, or out of the assets of, one or more companies."*[48]

Once the terms of the loan absent the guarantee are established, the transfer pricing rules must be applied to the guarantee itself.[49] In doing so, account must be taken of all factors, including whether the guarantee would have been provided at all, and if it would have been provided, but on different terms, the amount of and terms on that it would have been provided. HMRC guidance states that the value of the guarantee fee *"depends on the value of the guarantee to the borrowing party"* and is *"often calculated as a percentage of the principal concerned."*[50] A guarantee will only generally be of value to the borrower where it has the effect of reducing the borrower's borrowing costs. Therefore, where an excessive guarantee fee is paid, the value of that fee will generally only be deductible to the extent that it has reduced the arm's-length cost of borrowing.

Neither the legislation nor HMRC guidance specifies practical methods for calculating the value of the guarantee, but as with the valuation of other benefits under the arm's-length principle, it is necessary to read the legislation in a manner which best secure, consistency with the TPG, which includes the OECD recommended methods.[51] The OECD recommended methods are therefore just as applicable in the context of pricing guarantees as loans. As discussed (in Q1) in relation to the pricing of loans, the preferable method of pricing, provided a suitable comparator can be found, will be the CUP method.

Although not in scope where the guarantor is not subject to UK tax, it should be noted that in cases where an interest deduction is denied on the basis that the loan would not have occurred in an arm's-length situation, it is possible, provided various requirements are met, for the guarantor to claim the deduction denied to the borrowing party.[52] Similarly, where the borrower is subject to a restricted deduction on the guarantee fee, it may be possible for the UK taxpaying guarantor to claim a compensating adjustment.[53]

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

The UK has implemented the OECD's recommendation on BEPS Action 4 (limiting base erosion involving interest deduction and other financial payments) through the introduction of rules limiting tax deduction for interest expense and other financial expenses.[54] The aim of the new legislation is to align deductions with economic activities taking place in the UK by ensuring that groups cannot take advantage of the deductibility of interest by artificially maximizing deductions, using intra-group loans to create high value deductions or using debt-financing to generate tax-free income.

The rules apply to all companies. Other entities whose shares (or other interests) are listed on a recognized stock exchange, and not more than 10% of which are held by a single participator, are also subject to the restrictions.[55] The subsidiaries of companies or qualifying other entities are included (with certain exceptions).[56] The limits on deductibility do not apply to groups with a net interest expense of less than £2 million per annum.[57]

The "Fixed Ratio Rule" limits the amount of net interest expense that a worldwide group can deduct against its taxable profits to 30% of its taxable EBITDA.[58]

The "Group Ratio Rule" allows a "group ratio" to be substituted for the 30% figure.[59] The group ratio is based on the group's net interest expense to EBITDA ratio for the worldwide group by reference to its consolidated accounts.

Both rules are subject to a "modified debt cap," which ensures that the group's deductible interest does not exceed the group's net finance-related expense plus any excess in the modified debt cap carried forward from the previous period.

Unused interest capacity can be carried forward for use in future periods (although generally for not more than five years).[60]

The interest deductibility restriction rules provide that all other UK tax rules that deny or restrict interest deductibility (including the transfer pricing rules) take priority.[61]

Thus, it is necessary first to apply transfer pricing rules and then apply the interest deduction limits to any remaining deductible amount. An application of the tax deduction limits therefore necessitates an application of the transfer pricing rules because the values on which the tax deduction limit is placed must be calculated by reference to those rules.

Regardless of the effect of the introduction of the rules on HMRC's enforcement of transfer pricing of related party loans, it is likely that the introduction of the interest barrier will reduce the incentive of companies aggressively to price debt since their ability to take advantage of interest deductions is capped.

Specific thin capitalisation or other specific debt vs. equity rules do not limit the operation of the transfer pricing rules more generally. The UK had separate express thin capitalisation rules[62] that were independent of transfer pricing legislation until 2004, when the separate thin cap rules were scrapped.[63] Since 2004 thin capitalisation has been dealt with under the transfer pricing regime in Part 4 of TIOPA 2010. Also since 2004, the arm's-length principle has applied to determining quantity of debt which can be taken on by a borrower as well as the pricing of that debt. Where a related party makes a loan to a borrower that confers a potential UK tax advantage (for thin capitalisation purposes based on the size of the debt, see situations three and four in response to Q3), it is necessary to determine the amount of debt that would have been loaned at arm's-length. HMRC guidance[64] indicates that the factors used to determine the arm's-length quantity of debt include the purpose of the loan, the extent of other existing debt, security available, expected cash flow, credit status, history of the business, and market factors.

Murray Clayson is a Partner in the London Tax practice of Freshfields Bruckhaus Deringer LLP and Xander Friedlaender is a Trainee Solicitor at Freshfields Bruckhaus Deringer LLP. They can be contacted at the following email addresses:

murray.clayson@freshfields.com

Alexander.FRIEDLAENDER@freshfields.com

https://www.freshfields.us/

NOTES

[1] *Ametalco UK v IRC* [1996] STC (SCD) 399, a decision on the UK's simple historic transfer pricing rule.
[2] S.148 TIOPA 2010.
[3] S.147 TIOPA 2010.
[4] S.164 TIOPA 2010.
[5] S.147(1)(a),(b),(d) and (2)-(6), and s.148 and S.151(2).
[6] *DSG Retail Ltd and others v Revenue and Customs Commissioners* [2009] STC (SCD) 397.
[7] INTM421010, INTM421030.
[8] TPG para 2.2-2.3.
[9] INTM421010; TPG, para. 2.2-2.3.
[10] INTM501040.
[11] INTM516030.
[12] *Id*.
[13] INTM421010.
[14] INTM501010.
[15] As in Article 9(2) OECD Model Tax Convention on Income and on Capital (2017).
[16] S.148, s.147(1)(b) TIOPA 2010.
[17] S.147(2)(b) TIOPA 2010.
[18] INTM501040.
[19] *Ametalco UK v IRC* [1996] STC (SCD) 399.
[20] S.147 TIOPA 2010.
[21] S.153 TIOPA 2010.
[22] Chapter 5 Part 4 TIOPA 2010.
[23] S.147(1)(d) TIOPA 2010, INTM413030, INTM524080.
[24] INTM413030.
[25] INTM413070, INTM517050.
[26] INTM517050.
[27] *Id*.
[28] SP 1/12.
[29] ss.153-154 TIOPA 2010.
[30] *General Electric Capital Canada Inc v The Queen*, 2009 TCC 563.
[31] INTM501050.
[32] *Id*.
[33] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* ([2017] FCAFC 62).
[34] INTM516050.
[35] Schedule 10 Finance Act 2016.
[36] S.259NEA TIOPA 2010.
[37] Part 10 TIOPA 2010.
[38] INTM550000-597000.
[39] INTM551000.
[40] S.21(1) Corporation Tax Act 2009.
[41] *Id*.
[42] INTM267130.
[43] INTM267120.
[44] *Id*.
[45] S.153(5),(6) TIOPA.
[46] INTM413120.
[47] S.153(1) TIOPA 2010.
[48] S.154 TIOPA 2010.
[49] S.153(2) TIOPA 2010.
[50] INTM501050.
[51] S.164 TIOPA 2010.
[52] SS.191-192 TIOPA 2010.
[53] S.174 TIOPA 2010.
[54] Part 10 of, and Schedule 7A to, TIOPA 2010.
[55] SS.396, 474(1)-(2) TIOPA 2010.
[56] S.473(1)(b) TIOPA 2010.
[57] S.392(3)(a) TIOPA 2010; CFM95220.
[58] S.397 TIOPA 2010.
[59] S.398 TIOPA 2010.
[60] S.393; S.395 TIOPA 2010.
[61] S.155(6) TIOPA 2010.
[62] S.209(2)(da) Income and Corporation Taxes Act 1988.

[63] Finance Act 2008, INTM423020.

[64] INTM516030.

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United States

Michelle Johnson, Stefanie Perrella, Leda Zhuang, Michael Berbari, and Zachary Held
Duff & Phelps, United States

1. Does your country specify permissible methods for evaluating an arm's-length interest rate on related party loans? What methods does it specify – or which does it permit if it does not specify methods – (e.g., CUP, reference to interest indices, or percentage mark-ups over a base such as the national bank interest rate)? Do local tax inspectors tend to apply particular methods over others? What methods have you found to be effective, or do you see most often used for financial transactions, and what evidence do taxpayers or the government's examiners use to establish the rate under those methods?

In the U.S., related party loans are covered under the country's transfer pricing rules found in Internal Revenue Code ('IRC') Section 482 and its corresponding regulations under Treasury Regulations Section 1.482 ("U.S. Transfer Pricing Regulations"). Loans form part of a special category of regulations under 1.482-2 entitled *"Determination of Taxable Income in Specific Situations."* Unlike other types of related party transactions, such as the transfer of tangibles or the provision of intragroup services, the rules for pricing related party indebtedness are somewhat unique in that they do not prescribe a specific set of traditional transactional and profit-based methods. Instead, the U.S. Transfer Pricing Regulations prescribe a generic requirement that loans between related parties reflect interest rates that would have been charged between unrelated parties under similar circumstances.[1] Within this general endorsement of the arm's-length standard for related party loans, the U.S. Transfer Pricing Regulations outline specific circumstances where two formulaic approaches may be applied and are considered to constitute an arm's-length result. However, the rules make clear that taxpayers are free to demonstrate compliance with the generic prescription of the arm's-length standard as an alternative even where criteria for the formulaic approaches are met.

Before dissecting the methods in further detail, it is important to note that the U.S. Transfer Pricing Regulations only apply to bona fide indebtedness between related parties.[2] Therefore, no analysis of the interest rate can be considered arm's-length unless the intercompany financing arrangement in question represents bona fide indebtedness. Further discussion on the framework governing the characterization of debt transactions can be found under question 3, below.

Once a taxpayer can establish that a related party transaction represents a bona fide indebtedness, in practice there are three routes that taxpayers can use under the U.S. Transfer Pricing Regulations to determine an arm's-length interest rate for a related party loan:

Funds Obtained at Situs of Borrower: The U.S. Transfer Pricing Regulations indicate that where a taxpayer borrows funds from a third party at the situs of the borrower, and then on-lends those funds to the related party borrower, the arm's-length interest rate should be equal in both transactions (after adjusting the related party transaction for any administrative costs incurred on behalf of the related party lender).[3] Taxpayers can use a different rate if they can establish that the alternative rate is more appropriate under the arm's-length standard.

Safe Haven Interest Rate: Loans that meet the following three requirements are eligible to use between 100 and 130 percent of the Applicable Federal Rate ('AFR') as arm's-length interest rates: 1) The loan is made after May 8, 1986;[4] 2) The lender is not engaged in the business of making loans (i.e., is not a bank/financial institution);[5] and 3) The loan is denominated in U.S. Dollars.[6] The AFR is published via revenue rulings on a monthly basis by the IRS. There are three categories of AFR that are to be applied to intercompany loans of matching periods: 1) short-term AFR for loans under three years; 2) mid-term AFR for loans over three years and under nine years; and 3) long-term AFR for loans over nine years. The IRS uses U.S. government securities of similar terms to calculate the AFR. As a result, the AFR is typically below arm's-length interest rates for corporate borrowers and lenders. Taxpayers may gravitate to employing this safe harbor in situations where the borrower is located outside the U.S. (as foreign tax authorities are unlikely to object to an artificially low rate) and where appetite for tax risk and compliance costs are low. Taxpayers are free to use or not use the AFR-based safe harbor at their own discretion assuming the requirements are met.

Arm's-Length Interest Rate: Where one of the two conditions listed above cannot be applied or is not elected to be applied, taxpayers must select an arm's-length rate of interest that:

"(S)hall be a rate of interest which was charged, or would have been charged, at the time the indebtedness arose, in independent transactions with or between unrelated parties under similar circumstances. All relevant factors shall be considered, including the principal amount and duration of the loan, the security involved, the credit standing of the borrower, and the interest rate prevailing at the situs of the lender or creditor for comparable loans between unrelated parties."[7]

Where taxpayers elect to demonstrate an arm's-length result without reference to the AFR or situs of the borrower approaches, an analysis rooted in comparable uncontrolled transactions is most commonly applied.

2. Does the country officially (or do tax inspectors in practice) express a preference for valuation methods or approaches that are different for outbound transactions (domestic lender/foreign borrower) than for inbound ones?

The U.S. Transfer Pricing Regulations endorse the arm's-length standard for valuation of intercompany loans regardless of whether the transactions are inbound or outbound. However, it should not go unnoticed that the U.S. Transfer Pricing Regulations allow for the use of the AFR as a safe haven, which is in practice often only realistic for application in pricing outbound transactions (i.e., arrangements in which a non-U.S. entity is borrowing from a U.S. entity). As discussed above, the AFR safe haven often produces a rate lower than market rates. A lender in a country that does not recognize the U.S.'s safe harbor would likely be at risk of an adjustment if the tax authority perceived it was receiving less than an arm's-length amount of income on such a transaction.

It should also be noted that the regulations under § 385 ("385 Regulations") finalized in October 2016 require documentation establishing the bona fide nature of any intercompany loans only for inbound transactions (i.e., U.S. entity is the borrower). In theory inbound and outbound loans are subject to the same bona fide indebtedness requirements and arm's-length standard pricing framework, however, in practice this means inbound transactions are subject to different compliance standards when it comes to debt characterization.

3. Assume a typical related-party borrowing situation in your country: a foreign member of a multinational group has lent money to a domestic affiliate. It must be established whether the borrowing is on an appropriate arm's-length basis. How are these issues dealt with in your country?

a. What factors are examined to establish the loan's "bona fides;" that an advance or a loan agreement sets out genuine debt? Is it necessary to show that the loan would have been made by an unrelated lender, absent a guarantee? Is there a separate consideration of whether the "borrowing" is in fact an equity infusion? What happens if the loan is interest-free, and what happens if there is no written agreement?

After release of the final 385 Regulations in October 2016, taxpayers with U.S. related party borrowers are focused more than ever on substantiating their related borrowings as bona fide debt. These regulations were intended to formalize standards for determining debt characterization. Specifically, the regulations under Section 1.385-2 include strict documentation requirements demonstrating compliance with four criteria wherever the U.S. entity is the borrower in order to be considered bona fide debt:

1. An unconditional and binding legal obligation by the debtor to repay a sum certain on demand or at one or more fixed dates;
2. Adequate rights for the creditor to enforce the terms of the agreements including triggering default;
3. Demonstration of a reasonable expectation of repayment, which is often interpreted as an economic analysis showing that the lender is not over-leveraged and is capable of making interest and principal payments; and,
4. The debtor and creditor exhibiting an ongoing relationship during the life of the obligation that is generally consistent with the arm's-length relationships between unrelated debtors and creditors.

While the 385 Regulations never explicitly use language requiring taxpayers to prove an unrelated lender would have made a loan under comparable terms and circumstances as the related party loan, many of the requirements under Section 385 are aimed at documenting conditions that would be correlated with such a requirement.

In April 2017, the current administration released an executive order requesting that Treasury review regulations that impose an undue financial burden on taxpayers, add undue complexity to tax law, or exceed the IRS's statutory authority. Treasury, in its response in September 2017, raised the 385 Regulations (among others) as meeting those criteria and noted that Treasury and the IRS are considering proposals to revoke the documentation requirements under 385 Regulations in their present form and replace them with a streamlined and simplified approach. In the meantime, Treasury has pushed the effective date of the regulations back to January 2019.

While the ultimate status of the 385 Regulations is uncertain and documentation standards remain delayed, taxpayers in the U.S. nonetheless are open to challenge under the existing precedents established under common law.

Several court cases have established guiding principles for analyzing the characterization of debt transactions. Perhaps one of the most notable, *Estate of Mixon v. United States*, 464 F.2d 394 (5th Cir. 1972), established thirteen "Mixon Factors" used to determine whether debt may be considered debt. The thirteen factors are as follows:

1. The names given to the certificates evidencing the indebtedness;
2. The presence or absence of a fixed maturity date;
3. The source of payments;
4. The right to enforce payment of principal and interest;
5. Participation in management flowing as a result;
6. The status of the contribution in relation to regular corporate creditors;
7. The intent of the parties;
8. "Thin" or adequate capitalization;
9. Identity of interest between creditor and stockholder;
10. Source of interest payments;
11. The ability of the corporation to obtain loans from outside lending institutions;
12. The extent to which the advance was used to acquire capital assets; and
13. The failure of the debtor to repay on the due date or to seek a postponement.

These factors (along with those established in other court cases such as *Fin Hay Realty Co.*, 398 F.2d 694 (3d Cir. 1968); *Lantz Co.*, 414 F.2d 1330 (9th Cir. 1970), and *Hardman v. United States*, 827 F.2d 1409, 1411 (9th Cir. 1987)) are viewed in practice less as a "checklist" and more as a list of items that courts will consider when making a balanced and holistic assessment of an intercompany instrument. Failure to meet one of the listed criteria is not necessarily an automatic disqualifier, not all criteria apply in all cases, and many of the criteria do not lend themselves to a simple "yes" or "no" answer, but rather to an assessment as to the degree to which the criteria are met.

In short, U.S. regulators and courts have clear preferences for how loans are structured but intercompany arrangements are analyzed on a case-by-case basis. One of the single most important actions taxpayers can take is to ensure any intercompany arrangement is accompanied by an explicit written agreement and that there is some evidence that the borrower could be reasonably expected to repay under the terms of that agreement. Thereafter, taxpayers should ensure the creditor-debtor relationship is adhered to (e.g., interest payments are settled on time) and that the borrower is reasonably capitalized.

New interest expense deduction limitations and potential minimum tax requirements that could be triggered by related party interest payments that were enacted as a component of tax reform in the U.S. could decrease the focus on characterization when it comes to alleged related party indebtedness, but it will be another year before effects of the reform can be analyzed.

b. Under the current regulatory regime and case law, should the borrower be evaluated as a stand-alone borrower, or as a member of a multinational group benefiting from passive association with its group? Is implicit support from affiliates assumed, or what factors must be identified to suggest that such support might be given? Is this viewed as an exception to the traditional arm's-length standard or as a necessary interpretation of it, or something else?

At the time this response was written, the IRS and Treasury have not issued substantial guidance on how the notion of implicit support should be treated in the context of intercompany financing transactions. Practitioners can point to passages in the U.S. Transfer Pricing Regulations, depending on the interpretation, both for and against whether the impact of implicit support should be factored and priced in the context of an intercompany financing transaction.

For example, where the arm's-length standard is promulgated in the U.S. Transfer Pricing Regulations, under § 1.482-1(b)(1), there are phrases seemingly both in support of and against the factoring of implicit support:

"A controlled transaction meets the arm's-length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances."

Some point to the phrase "consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction" to argue that the arm's-length standard must be applied in such a fashion so that the parties are analyzed as separate and independent entities (i.e., no implicit support should be factored). Others point to the phrase "under the same circumstances" as a rationale for considering the existence of group relationships (i.e., implicit support). In other words, if a third-party bank were lending to a subsidiary, proponents of considering the existence of implicit support argue that a third-party bank would factor the subsidiary's relationship with the other group entities when evaluating comparable transactions.

The service regulations outlined under § 1.482-9 also have language that seemingly provides support for and against the factoring of implicit support. Specifically, § 1.482-9(l)(3)(v) states,

"A controlled taxpayer generally will not be considered to obtain a benefit where that benefit results from the controlled taxpayer's status as a member of a controlled

group. A controlled taxpayer's status as a member of a controlled group may, however, be taken into account for purposes of evaluating comparability between controlled and uncontrolled transactions."

The passage on passive association seemingly definitively states that no benefit is conferred due to being a member of a controlled group. However, it goes on to state that such membership may be considered when evaluating potential comparable transactions.

Practitioners evaluating an arm's-length price for intercompany financial transactions in the U.S. should tread carefully when considering implicit support, especially when transactions take place with non-U.S. jurisdictions that have more definitive practices for evaluating implicit support.

c. What other factors than the borrower's position as a stand-alone entity or member of a multinational group would be taken into account in evaluating the borrower's credit worthiness?

The IRS generally accepts synthetic credit ratings based on tools or guidance from rating agencies such as S&P or Moody's as being acceptable means for evaluating creditworthiness. Such tools generally look at qualitative and quantitative inputs such as industry, size, and financial standing based on leverage and coverage ratios. In applying this approach, practitioners should be careful to evaluate if the terms specific to the intercompany debt in question require any adjustment to the intercompany borrower's synthetic credit rating. For example, in the external market for debt it is common to see issuance level ratings for specific debt instruments vary from the issuer's overall credit rating resulting from issuance specific terms that result in issuance specific risk.

d. What sources of data for comparable loan benchmarking are typically referenced when undertaking an intercompany loan analysis?

Practitioners seeking to determine an arm's-length interest rate for an intercompany loan in instances where the safe haven and situs of the borrower rules are not selected have a plethora of data available to them. When determining what data to use, practitioners should carefully consider the nature of their intercompany transaction to determine what type(s) of external debt transaction(s) are most comparable. In the U.S., potential comparable debt transactions can come from the loan markets, bond markets, or private debt markets where data are available.

In our experience, there is no one market for debt that should be considered best in all contexts. Instead, the terms and conditions of the intercompany debt should be analyzed carefully to determine which area of the debt markets will be best suited for finding comparable transactions. For example, if an intercompany arrangement is similar to a revolving credit facility, whereby the borrower has the right to draw on a line of credit at a floating rate of interest, then the analysis should look for comparable transactions in loan markets where such types of arrangements are most likely to be observed. Conversely, if an intercompany arrangement consists of a 10-year term to maturity and fixed interest rate, then the bond market may provide more useful data than other sources.

Taxpayers are well served to attempt to structure their arrangements in ways that reflect characteristics that are similar to those observed in actual market transactions. In practice, one of the best sources for comparable uncontrolled transactions is internal transactions with third-party lenders. Most companies have some form of third-party debt within their structures that can be used as a data source for identifying typical terms. Practitioners would be unwise to ignore these internal transactions with third-party lenders as tax authorities are likely to compare the intercompany terms and interest rates directly to these transactions.

It is also important to note that the U.S. Transfer Pricing Regulations caution against use of "unadjusted industry average returns"[8] when establishing arm's-length pricing. Taxpayers and practitioners should therefore be careful about relying on unadjusted yield curves for establishing arm's-length pricing. In practice, use of yield curves (i.e., composite interest rate data by term, industry, credit rating, etc.) is quite common. Where possible, taxpayers and practitioners should seek to identify individual comparable transactions or, alternatively, yield curves should be adjusted where possible in order to increase reliability.

e. What, if any, safe-harbor rates or indicative or "suggested" margins are provided? Does the tax authority have (or has it indicated) an intention to provide such guidance?

Please refer to question 1 for a discussion on the U.S. Transfer Pricing Regulations safe harbor provisions.

f. How do you deal with negative interest rates in the context of deposits (e.g., in related financing institutions or similar situations)? How do you deal with base rates that are negative (such as Euribor, which as this is written are negative)?

The Federal Reserve Bank in the U.S. has never set a policy of negative interest rates and as a result negative interest rates in the context of USD-denominated loans have not been an issue historically.

4. In light of BEPS Action 2 (Hybrid Mismatch Arrangements) a number of countries during the last year have been enhancing, modifying, or adopting rules that affect transfer pricing of financial transactions. If changes have recently been made to your country's rules, what changes are those, and when do they take effect?

The Tax Cuts and Jobs Act ("2017 act") was approved by Congress and signed by the U.S. President on December 22, 2017. As a result, Section 267A was added to address certain related party amounts paid or accrued in hybrid transactions[9] or with hybrid entities[10], effective December 31, 2017. In general, Section 267A denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity. A disqualified related party amount means any interest or royalty paid or accrued to a related party to the extent that: (1) such amount is not included in the income of such related party under the tax law of the country of which such related party is a resident for tax purposes or is subject to tax; or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a U.S. shareholder under section 951 (a). IRC Section 267A(e) further provides that the Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section[11].

5. How do your country's rules for attribution of income to a permanent establishment work with the rules on debt financing? In particular does the "distinct and separate enterprise" view of a PE's income calculation permit (or require) separate entity evaluation of the PE?

The 2016 United States Model Income Tax Convention discusses taxation of interest in Article 11, and permanent establishments in Article 7. In general, under the 2016 Model, any income, profit or gain attributable to a permanent establishment ('PE') is taxable in the location where the PE is situated. In addition, when attributing profits to a PE, such profits are determined based on a standard similar to the arm's-length standard (i.e., attributable profits are the profits the PE would be expected to make if it were a separate and independent enterprise engaged in the same or similar activities, under the same or similar conditions, taking into account the functions performed, assets used, and risks assumed by the enterprise). In practice it is not common for companies to structure a legally binding loan with (solely) a PE. However, the U.S. generally tends to take a distinct and separate enterprise view when it comes to PEs.

6. If a foreign affiliate provides an explicit loan guarantee, when do your country's rules or your country's practice indicate that a guarantee fee must be accounted for? (If it must, when can it be an adjustment to the interest rate, or when must a separate guarantee fee be deemed to be paid to the foreign affiliate?) How is the appropriate charge for a guarantee determined?

When analyzing an explicit intercompany guarantee in the U.S., the key first question one must ask is whether or not the guarantee arrangement in place is compensable. Practitioners in the U.S. have typically looked to the U.S. Transfer Pricing Regulations under § 1.482-9 which govern services transactions for guidance as to the compensability of intercompany guarantees. Under § 1.482-9(I), the services regulations specify that a "*controlled services transaction*," i.e., a related party transaction that provides a "*benefit*" to the service recipient through "activities" of the service provider must be priced at arm's-length.

The term "*activity*' as defined under § 1.482-9(I)(2) is defined to include:

"the performance of functions, assumptions of risks, or use by a renderer of tangible or intangible property or other resources, capabilities, or knowledge, such as knowledge of and ability to take advantage of particularly advantageous situations or circumstances. An activity also includes making available to the recipient any property or other resources of the renderer."

Under the above definition, from an economic perspective, the provision of an explicit guarantee would seem to constitute an "*activity*" under the U.S. Transfer Pricing Regulations as such an arrangement represents the assumption of risk by one party on behalf of another. Assuming an intercompany guarantee results in the performance of an activity based on the definition above, then the next key question that must be answered is whether the guarantee results in a "benefit." Treasury Regulation 1.482-9(l)(3)(i) states,

"An activity is considered to provide a benefit to the recipient if the activity directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient's commercial position, or that may reasonably be anticipated to do so. An activity is generally considered to confer a benefit if, taking into account the facts and circumstances, an uncontrolled taxpayer in circumstances comparable to those of the recipient would be willing to pay an uncontrolled party to perform the same or similar activity on either a fixed or contingent-payment basis, or if the recipient otherwise would have performed for itself the same activity or a similar activity."

The determination of whether an intercompany guarantee confers a benefit is one that must be answered on a case-by-case basis as the answer could vary considerably even where an explicit guarantee is made. The U.S. Transfer Pricing Regulations make clear that the mere association between parties, i.e., "*passive association*," does not give rise to a benefit. Further reading under Example 16 under § 1.482-9 illustrates that the provision of a guarantee may give rise to a benefit where the existence of that guarantee allows the recipient to receive "*materially more favorable terms than otherwise would have been possible.*"[12] An economic and functional analysis must be performed to determine whether a guarantee results in the guaranteed entity having a more favorable economic position as a result of the guarantee. It is possible that even where an explicit guarantee is provided, no benefit is conferred.

If a benefit is found to have been conferred, then the pricing approaches used to determine this amount are the same as other jurisdictions (e.g., yield approach). One feature that is somewhat unique about the U.S. is the existence of a robust market for credit default swaps, which are third party instruments that transfer the risk of loans from one party to another, which may potentially serve as comparable uncontrolled transactions.

7. If your country has adopted interest deduction limits, such as the OECD's suggested ratio or group ratio approach, what are those measures? Do you expect that those measures will reduce the need for strict enforcement of transfer pricing in regard to related-party loans, by making it less tax-efficient to erode the domestic tax base through interest charges? Do thin capitalization or other specific limits such as debt vs. equity rules limit the operation of transfer pricing more generally? If so, how do these affect decisions that companies might make?

A key provision of the U.S. Tax Reform, which was passed into law and became effective on December 22, 2017, is a limitation to interest expense deductibility for U.S. income tax purposes. This limitation, codified as a revision to Section 163(j), and effective for tax years beginning after December 31, 2017, caps deductions for net business interest expense at 30 percent of adjusted taxable income ('ATI') plus floor-plan financing interest. For tax years beginning before January 1, 2022, ATI for corporations is computed ignoring all non-business items (e.g., non-business gains or losses) and without regard to any deduction allowable for depreciation, amortization, or depletion, which is similar to tax EBITDA. Thereafter, ATI would not include the addition of depreciation, amortization, or depletion. As such, ATI narrows to a measurement akin to taxable EBIT. The cap applies to interest associated with both new and existing, and with both related party and third-party debt. Of note, disallowed net business interest expense in any tax year can be carried forward indefinitely, but cannot be carried back. When analyzing the impact of this new interest cap, consideration should be given to the interplay with other provisions of the 2017 Act (e.g., temporary immediate expensing of capex, BEAT, and GILTI, etc.).

With the revision to Section 163(j) there is no longer a thin capitalization safe harbor in the U.S. (e.g., the old Section 163(j)). That said, as discussed above, for the time being, the 385 Regulations still stand. Finalized on October 21, 2016, the 385 Regulations provide restrictions and minimum documentation requirements around the recognition of intercompany financing instruments as debt (and corresponding payments as tax-deductible interest) for U.S. federal income tax purposes. The 385 Regulations under § 1.385-2 sets out four factors that are *"essential"* to the treatment of an instrument as debt and established minimum contemporaneous documentation requirements for debt characterization, which, following an extension, now apply to instruments issued by U.S. corporations of a certain size, generally speaking, on or after January 1, 2019. These rules are generally consistent with a market-based approach to debt characterization assuming the appropriate documentation is prepared. The 385 Regulations under § 1.385-3, under two sets of complex rules – the general and funding rules recast instruments issued in connection with certain activities that are seen as not funding investment in the U.S. as equity. In other words, these rules do not apply a cap to debt, but rather restrict its use. These recast rules, which are currently in effect, are expected by U.S. Treasury, per a statement in October last year, to potentially be rendered obsolete by the recent tax reform.

As noted above, the impact of U.S. tax reform on intercompany financial arrangements and the current U.S. regulations (e.g., arm's-length pricing per the U.S. Transfer Pricing Regulations and characterization per the 385 Regulations) remains to be seen. Formally speaking, these U.S. regulations are still in place and it is expected they will remain so, with the potential exception of § 1.385-3, as noted above.

With the inclusion of the above mentioned carryforward provision, this new limitation may be more of a constraint on the timing of the interest deduction rather than the loss of the interest deduction altogether (as is the case in other jurisdictions that do not have similar carryforward provisions). This is especially true for companies with growth in ATI that outpaces the growth in net business interest expense, and is of course dependent on the facts and circumstances driving the taxpayer's financials. Given that these instruments can still be used to erode the U.S. federal income tax base over time, we expect continued scrutiny on both characterization and pricing. With respect to pricing, documentation to support both interest paid and received by U.S. taxpayers will likely continue to be important as taxpayers look to maximize their interest deductions and the new rule is based on a net measure. As mentioned above, the impact of this provision should also be considered in the context of the broader U.S. tax reform.

Michelle Johnson is a Managing Director in Transfer Pricing at Duff & Phelps; Perrella is a Managing Director in Transfer Pricing at Duff & Phelps; Leda Zhuang is a Director in Transfer Pricing at Duff & Phelps; Michael Berbari is a Vice President at Duff & Phelps; and Zachary Held is a Vice President in Transfer Pricing at Duff & Phelps.
They may be contacted at:
Michelle.Johnson@duffandphelps.com
Stefanie.Perrella@duffandphelps.com
Leda.zhuang@duffandphelps.com
Michael.Berbari@duffandphelps.com
Zachary.Held@DuffandPhelps.com
https://www.duffandphelps.com/

NOTES

[1] Treas. Reg. § 1.482-2(a)(2)(i).
[2] Treas. Reg. § 1.482-2(a)(1)(ii)(A).
[3] Treas. Reg. § 1.482-2(a)(2)(ii).
[4] Treas. Reg. § 1.482-2(a)(2)(iii)(A)(1)(ii).
[5] Treas. Reg. § 1.482-2(a)(2)(iii)(D).
[6] Treas. Reg. § 1.482-2(a)(2)(iii)(E).
[7] Treas. Reg. § 1.482-2(a)(2)(i).
[8] Treas. Reg. § 1.482-1(d)(2).
[9] A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for Federal income tax purposes and which are not so treated for purposes the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax.
[10] A hybrid entity is any entity which is either: (1) treated as fiscally transparent for Federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally

transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for Federal income tax purposes.

[11] IRC § 267 (A)(e) outlines the areas that are intended to be addressed by forthcoming regulations.

[12] Example 16 uses a performance guarantee to illustrate this point however it stands to reason that a guarantee for a loan would be subject to the same economic framework in determining whether a benefit is conferred.

Transfer Pricing Forum Editorial Board and Country Panelists

Editorial Board Members

Murray Clayson
Editorial Board Member and Panelist for United Kingdom
Tax Partner, Freshfields Bruckhaus Deringer, London

Murray Clayson is a partner in Freshfields' tax practice group and is based in London, and leads the firm's international transfer pricing practice. He specializes in international tax, finance and capital markets taxation, corporate structuring, transfer pricing, banking and securities tax, asset and project finance, derivatives and financial products, particularly cross-border.

Murray is listed in *Chambers Europe, Chambers UK, The Legal 500 UK, Who's Who Legal, PLC Which Lawyer? Yearbook, Tax Directors Handbook, Legal Experts and International Tax Review's World Tax*. He is a fellow of the Chartered Institute of Taxation, past-Chairman of the British branch of the International Fiscal Association and a member of the CBI's Taxation Committee and International Direct Taxes Working Group.

Murray is a graduate of Sidney Sussex College, Cambridge, and holds a PhD from the University of London for research in the field of transfer pricing. He joined the firm in 1983 and has been a partner since 1993.

Patrick McColgan
Duff & Phelps LLP, Atlanta

Patrick McColgan is a managing director in Duff & Phelps' Atlanta office and part of the transfer pricing team. He has a strong focus on assisting growth companies with their global transfer pricing needs through the design of defensible and pragmatic solutions. Patrick has more than 11 years of transfer pricing experience and has worked across several industries including automotive, chemical, consumer products, medical products, pharmaceutical, software, internet, and manufacturing.

Mayra Lucas Mas
Editorial Board Member
Advisor, Tax Treaty, Transfer Pricing & Financial Transactions Division, Centre for Tax Policy and Administration, OECD, Paris

Mayra Lucas Mas has been an advisor at the Centre for Tax Policy and Administration, Tax Treaty, Transfer Pricing and Financial Transactions Division of the OECD since June 2008. She is responsible for chairing bilateral and multilateral transfer pricing events at OECD for the development of the OECD Transfer Pricing Guidelines, for the update of OECD Transfer Pricing Country Developments and for OECD accession review in the field of Transfer Pricing. She also provides technical assistance to non-OECD economies. In the past she has worked as a senior consultant for the transfer pricing group of a leading accounting firm and in the Taxation and Customs Union unit of the European Commission.

Mayra is a graduate of New York University School of Law (LLM), the University of Barcelona (Ph.D in Tax Law and Law Degree.) She has been a lecturer in tax law at the University of Barcelona, and a Research Fellow at the European Tax College at K.U. Leuven.

Rahul Mitra
Editorial Board Member and Panelist for India
Partner and National Head, Transfer Pricing & BEPS, KPMG India

Rahul K Mitra is currently the National Head of Transfer Pricing & BEPS for KPMG in India. Prior to joining KPMG India, Rahul was the national leader of PwC India's transfer pricing practice between 2010 and 2014. Rahul was a partner in the tax and regulatory services practice of PwC India between April 1999 and February 2015. Rahul has over 22 years of experience in handling taxation and regulatory matters in India. He specializes in transfer pricing, particularly inbound & outbound planning assignments, and advises on profit/cash repatriation planning; value chain transformation or supply chain management projects; profit attribution to permanent establishments, etc. Rahul independently handles litigation for top companies before the Income Tax Tribunals. At least 50 of the cases independently argued by Rahul have been reported in leading tax journals of India. Some of Rahul's major wins before the Tax Tribunals in transfer pricing matters have set precedents, both in India and globally.

In his personal capacity, Rahul has handled several APAs in India, involving clients from across industries; and also covering complex transactions, e.g. industrial franchise fees/variable royalties under non-integrated principal structures; contract R&D service provider model; distribution models, with related marketing intangible issues; financial transactions; profit split models for royalties; etc. He has been consistently rated as amongst the leading transfer pricing professionals and tax litigators in the world, by Euromoney and International Tax Review, since 2010.

Rahul has been a visiting member of the faculty of the National Law School in the subject of transfer pricing and international tax treaties, was the country reporter on the topic, "Non Discrimination in international tax matters", for the IFA Congress held in Brussels in 2008, and was invited by the OECD to speak in the 2012 Paris roundtable conference on developing countries' perspective on APAs.

Dirk van Stappen
Editorial Board Member
Partner, KPMG, Antwerp/Brussels

Dirk van Stappen is a partner with KPMG and leads KPMG's transfer pricing practice in Belgium. He joined KPMG in 1988 and has over 28 years of experience in advising multinational companies on corporate tax (both domestic and international) and transfer pricing issues. He leads KPMG's transfer pricing practice in Belgium. Furthermore, Dirk is a former member of the EU Joint Transfer Pricing Forum (2002-2015).

Since 1996, Dirk has been a visiting professor at the University of Antwerp (Faculty Applied Economics, UA) teaching Tax to Master students. He has been named in International Tax Review's "World Tax –The comprehensive guide to the world's leading tax firms", Euromoney's (Legal Media Group) "Guide to the World's Leading Transfer Pricing Advisers" and Euromoney's "Guide to the World's Leading Tax Advisers."

He is a certified tax adviser and member of the Belgian Institute for Accountants and Tax Advisers and of the International Fiscal Association.

Country Panelists

Argentina

Cristian E. Rosso Alba
Rosso Alba, Francia & Asociados, Argentina

Cristian Rosso Alba has a well-recognized experience in Tax Law, with particular emphasis in domestic and international tax planning, restructurings, reorganizations and international business transactions. He leads the Tax Law practice of Rosso Alba, Francia & Abogados.

Additionally, Mr. Rosso Alba has been a regular lecturer in the United States and speaker in domestic and international tax conferences and is the author of more than eighty articles appearing in specialised publications. Cristian Rosso Alba is a member of the American Bar Association (ABA), Harvard Club of Argentina, the Canadian Tax Foundation and the Advisory Board of the Argentine Chamber of Commerce. Mr. Rosso Alba has been recommended as one of the "Leaders in their Field" (Tax - Argentina) by Chambers Latin America.

Australia

Stean Hainsworth
Director, Duff & Phelps, Australia

Stean Hainsworth is the Director of Transfer Pricing at Duff & Phelps based in Australia and has over 20 years of legal and tax experience, specializing in transfer pricing. Previously he was a Director of an international transfer pricing firm, at a global advisory firm as the transfer pricing leader for Asia, and worked as a senior transfer pricing specialist for a Big 4 firm in New Zealand, Canada and Australia.

Austria

Alexandra Dolezel
Tax Director, PwC, Vienna

Alexandra Dolezel has been a Tax Director in the Vienna, Austria, practice of PricewaterhouseCoopers since 2011. There, she specializes in transfer pricing; international tax structuring and value chain transformation; and mergers and acquisitions. In addition, she is a lecturer on European Union tax law and comparative tax law at FH Campus Wien, the largest university in Austria. Prior to joining PricewaterhouseCoopers, she was Head of Corporate Taxes for Borealis AG, where she had overall responsibility for group corporate tax, including matters affecting tax risk management, transfer pricing and international structures. Ms. Dolezel received her education at the Vienna University of Economics and Business Administration, and she is also a member of the Austrian Chamber of Accountants.

Tanja Roschitz
Consultant, Transfer Pricing, PwC, Vienna

Tanja Roschitz is a transfer pricing consultant at PricewaterhouseCoopers.

Belgium

Dirk van Stappen
Partner, KPMG, Antwerp/Brussels

Dirk van Stappen is a partner with KPMG and leads KPMG's transfer pricing practice in Belgium. He joined KPMG in 1988 and has over 28 years of experience in advising multinational companies on corporate tax (both domestic and international) and transfer pricing issues. He leads KPMG's transfer pricing practice in Belgium. Furthermore, Dirk is a former member of the EU Joint Transfer Pricing Forum (2002-2015). Since 1996, Dirk has been a visiting professor at the University of Antwerp (Faculty Applied Economics, UA) teaching Tax to Master students. He has been named in International Tax Review's "World Tax –The comprehensive guide to the world's leading tax firms", Euromoney's (Legal Media Group) "Guide to the World's Leading Transfer Pricing Advisers" and Euromoney's "Guide to the World's Leading Tax Advisers." He is a certified tax adviser and member of the Belgian Institute for Accountants and Tax Advisers and of the International Fiscal Association.

Yves de Groote
Director, KPMG, Antwerp

Yves de Groote is a LL.M from King's College London, MSc. HUB; he joined KPMG in 2004 and has over 10 years of experience in advising multinational organizations on transfer pricing issues. He has been involved in and conducted various tax planning and transfer pricing assignments, ranging from the preparation of European and global transfer pricing documentation (including functional and economic analyses and comparables searches), domestic and international transfer pricing audit defense to the negotiation of (uni-, bi- and multilateral) rulings and advance pricing arrangements (APAs).

Eugena Molla
Senior Adviser, KPMG, Antwerp

Eugena Molla, MSc University of Bologna, is a Senior Tax Adviser with KPMG in Belgium, specializing in global transfer pricing services. She has assisted multinational clients in matters such as transfer pricing planning, global documentation and dispute resolution. Eugena also gained experience in global restructuring and supply chain management projects, as well as unilateral / bilateral advance pricing arrangements (APAs) for multinational companies in a range of sectors.

Brazil

Jerry Levers de Abreu
Partner, TozziniFreire Advogados, São Paolo

Jerry Levers de Abreu is a Partner at TozziniFreire Advogados, Sao Paulo.

Lucas de Lima Carvalho
Senior Tax Associate, TozziniFreire Advogados, Sao Paulo

Mr. Carvalho is a Tax Associate with TozziniFreire Advogados, Sao Paulo. In addition to his practice, he is a teacher and lecturer, and a frequently published author. He holds an LL.M. in International Taxation from New York University School of Law; an LL.M. in Corporate Law from the Instituto Brasileiro de Mercado de Capitais (IBMEC); an International Executive MBA from the Chinese University of Hong Kong; an MBA in Taxation from Fundacao Getulio Vargas (FGV), and an LL.B. (magna cum laude) from Federal University of Ceara.

Canada

Richard Garland
Partner, Deloitte LLP, Toronto

Richard Garland is a partner in the Toronto office of Deloitte. He is a Chartered Professional Accountant and has over 25 years of accounting experience focused in the area of corporate international taxation. Richard has assisted clients in all aspects of international taxation, with particular emphasis on tax treaty issues, cross border financing structures and transfer pricing. Over the past several years, Richard's work has been focused in the area of transfer pricing, and he has been repeatedly recognized in Euromoney's guide to leading transfer pricing practitioners.

China

Cheng Chi
Partner-in-Charge for China and the Hong Kong SAR, KPMG, Shanghai

Based in Shanghai, Cheng Chi is the partner-in-charge of KPMG's Global Transfer Pricing Services for China and Hong Kong S.A.R. Mr. Chi has led many transfer pricing and tax efficient supply chain projects in Asia and Europe, involving advance pricing arrangement negotiations, cost contribution arrangements, Pan-Asia documentation, controversy resolution, global procurement structuring, and headquarters services recharges for clients in the industrial market including automobile, chemical, and machinery industries, as well as the consumer market, logistic, communication, electronics and financial services industries .

In addition to lecturing at many national and local training events organised by the Chinese tax authorities, Mr. Chi has provided technical advice on a number of recent transfer pricing legislative initiatives in China. A frequent speaker on transfer pricing and other matters, his analyses are regularly featured in tax and transfer pricing publications around the world i.e. International Tax Review). Mr. Chi has been recommended as a leading transfer pricing advisor in China by the Legal Media Group.

Mr. Chi started his transfer pricing career in Europe with another leading accounting firm covering many of Europe's major jurisdictions while based in Amsterdam until returning to China in 2004.

Rafael Triginelli Miraglia
Senior Manager, KPMG, Shanghai, China

Rafael Triginelli Miraglia is a Senior Tax Manager with the Global Transfer Pricing Team of KPMG China and member of the firm's BEPS Center of Excellence. His practice focuses on design and implementation of transfer pricing systems, business restructuring advice, value chain analysis and planning and outbound investments. Rafael is graduated in Law (Universidade Federal de Minas Gerais, Brazil, 2004) and has obtained the degrees of Master of Laws (Pontificia Universidade Catolica de Minas Gerais, Brazil, 2008) and LL.M. of Advanced Studies in International Tax Law (ITC-Leiden University, the Netherlands, 2011). He is a Transfer Pricing Lecturer at the ITC-Leiden University and has taught courses in Tax and Constitutional Law at Pontificia Universidade Catolica de Minas Gerais. Rafael is a member of the Brazilian Bar Association (Ordem dos Advogados do Brasil) since 2005. Before joining KPMG China, Rafael worked between 2011 and 2015 as Tax Associate with a global law firm in the Netherlands and, prior to that, as Head of Tax with a Brazilian law firm.

Denmark

Arne Møllin Ottosen
Partner and Head of Tax Law, Kromann Reumert, Copenhagen

Arne Møllin Ottosen is Head of Kromann Reumert's tax law group. He specialises in contentious tax including transfer pricing, tax litigation and business taxation advisory work. Arne is the author of numerous Danish and international articles on tax and company law.

Arne is listed in the International Tax Review, European legal 500 and Chambers. He holds a Law degree, Aarhus University (cand.jur. 1993). LL.M., King's College, University of London (1999).

Casper Jensen
Attorney, Kromann Reumert, Copenhagen

Casper Jensen is an attorney and a member Kromann Reumert's tax law group. He specializes in corporate and international tax matters. Casper is the author of numerous articles on international taxation. He holds a law degree, University of Copenhagen (cand.jur. 2013).

France

Julien Monsenego
Partner in Tax Law, Olswang LLP, Paris

Julien Monsenego specialises in international taxation, tax treatment of M&A and restructurings. He assists French and foreign companies in their international investments as well as in the course of their tax audits and litigations. He particularly focuses on Life Science and R&D-intensive industries. He has extended practice of transfer pricing and has intervened for French and non-French groups in setting-up intra-group flows, IP companies and business restructurings.

Before joining Olswang, Julien Monsenego previously worked at Arthur Andersen International, Ernst & Young, Coudert Brothers and Dechert LLP. Mr. Monsenego is a member of the Paris Bar.

Guillaume Madelpuech
Principal (Transfer Pricing), NERA Economic Consulting, Paris

Mr. Madelpuech holds a MBA from the ESSEC Business School and an MSc in Economics from the Paris Dauphine University. He is a Principal within NERA Economic Consulting in Paris. He is an economist with 10 years of experience in transfer pricing, including in particular intangible valuation, business restructuring, transfer pricing policy design and litigation. Mr. Madelpuech has conducted a number of transfer pricing projects for multinationals in a wide range of industries, including high-tech, consumer goods, automotive, luxury goods, financial services, health care, real estate, media and entertainment, and energy. He is a regular contributor to the OECD and a frequent contributor to journals and trade publications. Prior to joining NERA, Mr Madelpuech was an economist with EY, in both Paris and in New York City, in the transfer pricing and valuation groups.

Germany

Alexander Voegele
Chairman, NERA Economic Consulting, Frankfurt

During more than 25 years advising international corporations and leading law firms on transfer pricing issues, Alexander Voegele has specialised in the development of innovative economic structures for transfer pricing strategies and for the defense of major international transfer pricing cases. He has led hundreds of large transfer pricing projects and defense cases for a variety of clients in a range of industries. Prior to joining NERA, Dr Voegele was a partner with PriceWaterhouse and KPMG, where he was in charge of their German transfer pricing practice.

He holds a doctorate in economics and a Master of tax and business administration from the University of Mannheim. He is a certified German auditor and tax adviser and is a French Commissaire aux Comptes.

He has received numerous awards as a transfer pricing adviser and has frequently been ranked as a leading tax and transfer pricing professional.

Philip de Homont
Senior Consultant/Principal, NERA Economic Consulting, Frankfurt

Philip de Homont specializes in complicated transfer pricing audits and the valuation of intellectual property for international corporations and law firms. He has defended major transfer pricing cases throughout Europe and the Americas in a wide range of industries from consumer goods to financial services.

He holds a MSc in Economics from the University of Warwick and a Masters-equivalent in Physics from the Technische Universität München.

Philip de Homont is the co-author of dozens of articles and two books on transfer pricing and intellectual property valuation. He has participated in various transfer pricing conferences.

Hong Kong

John Kondos
Partner, KPMG Global Transfer Pricing Services, Hong Kong

John Kondos is the Asia-Pacific Leader for Financial Services and the Financial Services Transfer Pricing team. He specializes in transfer pricing documentation, planning, controversy, and audit resolution matters, including competent authority negotiations. John has lived and worked in Asia for over 14 years, and has extensive experience with banking and capital markets, asset management, insurance, treasury and group service transactions in Japan, Korea, Hong Kong, Singapore, Taiwan and other Asian countries. He is a graduate of the University of Melbourne, and has a Bachelor of Commerce and Masters (Commerce & Business Administration) degrees from Kobe University in Japan.

Irene Lee
Director, KPMG Global Transfer Pricing Services, Hong Kong

Irene Lee has practiced tax for 11 years, the last 7 specializing in transfer pricing matters involving the financial services sector. She joined KPMG in Hong Kong in 2013, and advises banking, asset management, and insurance clients on transfer pricing policies, documentation, and risk management in the Asia region. She earned a Bachelors of Business Administration (B.B.A.) degree from the Chinese University of Hong Kong, and has studied at the University of North Carolina (Chapel Hill).

Jeffrey Wong
Manager of Global Transfer Pricing Services, KPMG Hong Kong

Jeffrey Wong is a Manager of Global Transfer Pricing Services at KPMG in Hong Kong.

India

Rahul Mitra
Partner and National Head, Transfer Pricing & BEPS, KPMG India

Rahul K Mitra is currently the National Head of Transfer Pricing & BEPS for KPMG in India. Prior to joining KPMG India, Rahul was the national leader of PwC India's transfer pricing practice between 2010 and 2014. Rahul was a partner in the tax and regulatory services practice of PwC India between April 1999 and February 2015. Rahul has over 22 years of experience in handling taxation and regulatory matters in India. He specializes in transfer pricing, particularly inbound & outbound planning assignments, and advises on profit/cash repatriation planning; value chain transformation or supply chain management projects; profit attribution to permanent establishments, etc. Rahul independently handles litigation for top companies before the Income Tax Tribunals. At least 50 of the cases independently argued by Rahul have been reported in leading tax journals of India.

Some of Rahul's major wins before the Tax Tribunals in transfer pricing matters have set precedents, both in India and globally.

In his personal capacity, Rahul has handled several APAs in India, involving clients from across industries; and also covering complex transactions, e.g. industrial franchise fees/variable royalties under non-integrated principal structures; contract R&D service provider model; distribution models, with related marketing intangible issues; financial transactions; profit split models for royalties; etc. He has been consistently rated as amongst the leading transfer pricing professionals and tax litigators in the world, by Euromoney and International Tax Review, since 2010.

Rahul has been a visiting member of the faculty of the National Law School in the subject of transfer pricing and international tax treaties, was the country reporter on the topic, "Non Discrimination in international tax matters", for the IFA Congress held in Brussels in 2008, and was invited by the OECD to speak in the 2012 Paris roundtable conference on developing countries' perspective on APAs.

Yashodhan D. Pradhan
Director, BSR & Co. LLP, Mumbai, India

Yashodhan is the Director at BSR & Co. LLP, located in Mumbai, India.

Ireland

Catherine O'Meara
Partner, Matheson, Dublin

Catherine is a partner in the tax department at Matheson. Catherine has over ten years' experience advising multinational corporations doing business in Ireland on Irish corporate tax. Catherine has a particular interest in transfer pricing, competent authority matters and business restructurings and also has extensive experience in structuring inward investment projects, mergers and acquisitions and corporate reorganisations. Catherine's clients include many of the leading multinational corporations established in Ireland, primarily in the pharmaceutical, healthcare, ICT and consumer brand sector. Catherine has published articles in leading tax journals, is co-author on the Ireland section of the Bloomberg BNA TP Forum and is co-author of the Ireland chapter of the International Fiscal Association Cahiers on Cross Border Business Restructuring.

Catherine is a Chartered Tax Advisor and a member of the Law Society of Ireland.

Israel

Yariv Ben-Dov
Partner, Herzog Fox & Neeman, Tel Aviv

Yariv Ben-Dov is the Head of Transfer Pricing and Valuations Department at Herzog, Fox & Neeman. He is an expert in drafting and defending transfer pricing studies and intercompany agreements, with over 15 years of experience. Yariv counsels both multinational conglomerates and small start-ups on their transfer pricing matters, including multinationals which have no activity in Israel. Prior to joining HFN, Yariv was a co-founder of Bar-Zvi & Ben-Dov, a boutique law firm specializing in transfer pricing and high-tech, and prior to that Yariv served as the Head of the Transfer Pricing Unit in Teva Pharmaceuticals. Yariv has published articles in the subject of transfer pricing and has been asked to keynote as an expert in transfer pricing at several conventions in Israel, Europe and the U.S..

Yariv is a member of Transfer Pricing Associates, the world's largest network of independent transfer pricing experts, a member of the Israeli Bar Tax Committee, and of the Board of the Israeli-LATAM Chamber of Commerce. Yariv is also a Board member of the Arthur Rubinstein Music Society and the head of the Society's NYC branch. Yariv counsels (pro bono) to the Israeli Navy Association. Yariv speaks Hebrew, English, French and Italian, and has often advised global clients in their local language.

Italy

Marco Valdonio
Associate Maisto & Associati, Italy

Marco Valdonio was admitted to the Association of Chartered Accountants in 2002. He joined Maisto e Associati in 2000, after working for another tax law firm and has become partner since 2011. He headed the London office from 2002 to 2004. His areas of expertise comprise transfer pricing, definition of tax controversies through settlement procedures, mergers and acquisitions, financial instruments and international taxation.

Aurelio Massimiano
Partner, Maisto e Associati, Milan

Aurelio Massimiano is a partner at Maisto e Associati, where he has practiced since 2005, after having worked for the International Tax Office of the Italian Revenue Agency, and prior to that, for a Big 4 accounting firm. His areas of expertise are international taxation and transfer pricing. He is the permanent assistant of Professor Guglielmo Maisto at the EU Joint Transfer Pricing Forum. A member of the Association of Chartered Accountants, he holds degrees from Luiss Guido Carli University in Rome, and an LL.M. in International Tax Law from the University of Leiden, The Netherlands.

Mirko Severi
Associate, Maisto e Associati, Milan

Mirko Severi joined Maisto e Associati in 2011 after obtaining a Master Diploma in Tax Law at IPSOA. He graduated (cum laude) in Economics from the University of Parma, in 2010. His areas of expertise include corporate taxation and group taxation.

Japan

Takuma Mimura
Cosmos International Management Co., Ltd

Takuma Mimura is Managing Director of Cosmos-International Management, a transfer pricing boutique consulting firm in Japan. He has more than 14 years of transfer pricing experience, including 6 years at Deloitte Touche Tohmatsu (both Tokyo and New York), and international banking experience prior to transfer pricing. He has worked extensively with transfer pricing issues worldwide and is especially experienced in Japan, U.S. and China Transfer Pricing matters. He has also worked with a broad range of clients in manufacturing, financial services and telecommunications and has assisted many taxpayers in negotiations with the Japanese tax authorities on transfer pricing audit examinations.

Takuma has authored articles for professional journals including BNA Transfer Pricing Report and Monthly International Taxation of Japan, and is a frequent speaker on transfer pricing topics.

Korea

Dr. Tae-Hyung Kim
Transfer Pricing, Korea

Dr. Tae-Hyung Kim is a former senior partner and national leader of the Global Transfer Pricing Group at Deloitte, Korea. Over more than 14 years, Dr. Kim has represented multinational corporations in various industries in transfer pricing audit defense, advance pricing agreement negotiations, mutual agreement procedures, and planning and documentation studies.

Prior to his previous position, Dr. Kim headed the national transfer pricing practice at other Big Four firm in Korea and the Law and Economics Consulting Group in Korea. Before specializing in transfer pricing, Dr. Kim was a research fellow for the Korea Institute for International Economic Policy (KIEP). During his tenure at the KIEP, he advised the Ministry of Finance and Economy, the Ministry of Commerce, Industry, and Energy and the Ministry of Foreign Affairs in the area of international trade and investment policies.

Dr. Kim' s recent publications appear in IBFD's International Transfer Pricing Journal, BNA Tax Management's Transfer Pricing Reports, and Euromoney's Transfer Pricing Reviews. His economics publications also appear in Canadian Journal of Economics and Review of International Economics.

He holds a Ph.D. in economics from the University of Washington and is a graduate of Advanced Management Programs of both Harvard Business School and Seoul National University.

Seong Kwon Song
Head of Transfer Pricing Group, Deloitte, Seoul

Mr. Seong Kwon Song, former Assistant Commissioner for International Tax Investigation and Head of the Competent Authority at the Korean National Tax Services (KNTS) leads the Deloitte transfer pricing group in Korea. The group has over 40 specialists including ex-KNTS officers and economists with global background.

Luxembourg

Peter Moons
Tax Partner and Head of the Transfer Pricing Team, Loyens & Loeff, Luxembourg

Peter Moons is a partner in the tax practice of Loyens & Loeff Luxembourg since 2004, with a focus on corporate tax advice for multinationals and funds, in particular private equity funds, their initiators and their investors. Before joining the Luxembourg office in 2004, he practiced in the Rotterdam and Frankfurt offices of Loyens & Loeff, specializing in real estate funds and cross-border tax structuring. Peter is also active in the Loyens & Loeff German and Eastern European desks and heads the Luxembourg transfer pricing team. Peter is a member of the Luxembourg Bar, the International Fiscal Association (IFA) and of the tax committee of the Luxembourg Private Equity and Venture Capital Association. Peter is the author of Tax Management Portfolio, Business Operations in Luxembourg, published by Bloomberg Tax. He received a Business economics and tax law degree from Erasmus University in Rotterdam in 1996 and Tax law degree from University of Cologne in 1997.

Gaspar Lopes Dias
Tax Advisor and Transfer Pricing Specialist, Loyens & Loeff, Luxembourg

Gaspar Lopes Dias is an associate in the tax practice group of Loyens & Loeff Luxembourg. He specializes in international taxation and transfer pricing, Gaspar advises on financial transactions (e.g. cash pool, debt pricing) and on intra-group services. Prior to joining our Transfer Pricing team, Gaspar worked at a big 4 company in Belgium, having gained experience in several industries and in a broad range of transfer pricing matters, including TP documentation, IP structuring and arm's length license fees, relocation of functions, MAP/EU Arbitration Convention and EU State Aid rules on transfer pricing. He received a degree in Advanced Transfer Pricing from ITC Leiden, an advance LLM in European and International Taxation from Tilburg University, and a law degree from Nova University of Lisbon.

Mexico

Moises Curiel Garcia
Principal-Director of the Latin American Transfer Pricing Practice, Baker & McKenzie, Mexico City

Moisés Curiel is a member of the Firm's Transfer Pricing Practice Group. He is recognized by International Tax Review as one of Mexico's top tax advisers, and has served as the Transfer Pricing Audits and Resolutions administrator of Mexico's Ministry of Finance and Public Credit for seven years. Mr. Curiel helped prepare and implement various tax transfer pricing rules in Mexico, including the Income Tax Law, the Omnibus Tax Ruling and the Federal Tax Code. He also led the Advance Pricing Agreements Program in Mexico, where he negotiated over 300 unilateral agreements and 34 bilateral agreements. His impressive track record also includes proposing amendments to legislation on various matters for Latin American countries, and representing Mexico before the OECD for the transfer pricing party (WP6).

Armando Cabrera
Partner, Baker & McKenzie, Mexico City

Armando Cabrera-Nolasco is a partner in Baker McKenzie's Tax Practice Group in Guadalajara. He has 10 years of experience in transfer pricing issues. Mr Cabrera- Nolasco currently coordinates the transfer pricing services for financial and services industries, and the financial valuation practice.

Mr. Cabrera-Nolasco's practice focuses on transfer pricing documentation for tax compliance; pricing strategies and benchmarking analysis by product, industry, country and region; defense in litigation; and alternative dispute resolution of any transfer pricing matter in Mexico and Latin America.

Jorge Ramirez
Associate, Baker & McKenzie, Mexico City

Jorge Ramirez Dorantes is a member of the Latin America Transfer Pricing Group. He has been a transfer pricing practitioner for over six years, with involvement in transfer pricing consulting/ restructuring, economic analysis and valuation, controversy support (audit and litigation defense), transfer pricing documentation, and negotiations with various tax authorities in the Latin America region.

Mr. Ramirez Dorantes has worked with clients in a broad range of industries, with considerable experience in transactions for the aerospace, retail and services industries. He has also participated in the negotiation of APAs for the maquiladora industry, and advising on the tax efficiency of supply chain operations. Aside from consulting projects, Mr. Ramirez Dorantes has substantial experience in the successful resolution of marketing intangibles audits.

The Netherlands

Danny Oosterhoff
Partner, Ernst & Young Belastingadviseurs LLP, Amsterdam, The Netherlands

Danny Oosterhoff is a Partner at Ernst & Young Belastingadviseurs LLP.

Olga Shambaleva
Senior Manager at Transfer Pricing & Operating Model Effectiveness group, Ernst & Young Belastingadviseurs LLP, Amsterdam, The Netherlands

Olga Shambaleva is a a Senior Manager at Ernst & Young Belastingadviseurs LLP.

New Zealand

Leslie Prescott-Haar
Managing director, TP EQuilibrium | AustralAsia LP ("TPEQ")

Leslie is the managing director of TP EQuilibrium | AustralAsia LP ("TPEQ") (formerly, Ceteris New Zealand). TPEQ provides transfer pricing services in Australia and New Zealand, across an extensive range of industries, transactions and engagements, including APAs; independent second opinions and expert advice; tax authority reviews, investigations and audit defence; global, regional and country-specific documentation; etc. Leslie has over 22 years of specialised transfer pricing experience based in the APac Region (Sydney and Auckland), and an additional 10 years of corporate taxation experience in Big 4 accounting firm practices specialising in mergers, acquisitions, bankruptcies and reorganisations based in the United States (New York City and Chicago). Prior to forming TPEQ, Leslie commenced the transfer pricing practice of Ernst & Young New Zealand, where she served as the National Leader for a number of years. Leslie frequently provides 'thought leadership' contributions to various international publications and associations.

Stefan Sunde
Senior Analyst, TPEQ

Stefan is a Senior Analyst at TPEQ. He joined TPEQ in 2013 in a university internship role, and since such time has worked on major projects for most of the practice's major client base and all industries, and has managed some more recent projects. Stefan completed his tertiary studies in 2014 and has since worked for the firm in a full-time capacity.

Sophie Day
Analyst, TPEQ

Sophie is an Analyst at TPEQ. She has over a year of transfer pricing experience since joining TPEQ in July 2015, working across various industries and projects for TPEQ's client base. Sophie completed her tertiary studies in 2016 and has since worked for the firm in a full-time capacity.

Portugal

Patrícia Matos
Associate Partner at Deloitte & Associados SROC, S.A., Lisbon

Patrícia Matos is currently Associate Partner in Deloitte's Lisbon office in the transfer pricing department.

Patrícia has a business degree and is a chartered accountant. She started her professional career in Arthur Andersen (Arthur Andersen, S.A., presently Deloitte & Touche as result of an effective association of both firms since April 2002) in 1997 and was promoted to Associate Partner in 2008.

Patrícia has extensive experience in tax planning, due diligence and tax compliance for Portuguese and Multinational companies. In 2002, she began working exclusively in transfer pricing. She advises clients in several aspects of transfer pricing, ranging from tax audits to comprehensive transfer pricing planning, structuring of intercompany transactions and defensive documentation.

Her experience spans a wide range of industries including communications, technology, media, financial services, automotive, consumer goods, tourism and pharmaceuticals.

Patrícia has been a speaker at several seminars and conferences on tax, economic and transfer pricing issues.

Henrique Sollari Allegro
Manager, Partner at Deloitte & Associados SROC, S.A., Lisbon

Henrique is currently a Manager in Deloitte's Lisbon office in the transfer pricing department.

Russia

Evgenia Veter
Ernst & Young, Moscow

Evgenia joined the firm as a partner in March 2011. Before that she worked for more than 15 years with another Big Four company where she obtained extensive experience in providing advisory services to Russian and international companies on various areas of taxation and conducting business in Russia, structuring investments, and coordinating approaches to tax planning. Since 2007 Evgenia has been focusing on transfer pricing. She has led transfer pricing planning and documentation projects for multinational and Russian clients in various industry sectors, including structuring of entry/exit strategies of clients from the transfer pricing perspective, adaptation of global transfer pricing policies to Russian requirements, business restructuring, development of sustainable transfer pricing methodologies, etc. Evgenia specialises on serving companies working in retail, consumer products and life science industries. She is currently a Partner in the Transfer Pricing Group for Ernst & Young in Moscow.

Ibragim Khochaev
Manager, Transfer Pricing Services, Ernst & Young, Moscow

Ibragim is a Manager with the EY Transfer Pricing Group in Moscow. He has specialized in transfer pricing for more than 5 years, and has actively participated in transfer pricing projects for foreign and Russian companies from various industries, including FMCG, chemical, Oil & Gas, automotive, pharma, etc. Ibragim has broad experience in conducting benchmarking studies, preparing TP documentations, designing the TP methodologies, business restructuring, intangible assets and intra-group financial transactions analysis. He graduated with honors from All-Russian State Tax Academy of the Ministry of Finance of the Russian Federation and holds a degree in Taxes and Taxation. Ibragim is currently studying for a Ph.D degree at the Plekhanov Russian University of Economics.

Singapore

Peter Tan
Senior Consultant (Tax and Transfer Pricing), Baker & McKenzie Wong & Leow, Singapore

Peter Tan leads the Baker & McKenzie Transfer Pricing practice in Singapore. He was called to the Bar of England and Wales in 1976, and started his tax career in London, continuing it in Singapore. Mr. Tan advises multinational companies from various industries on tax issues related to mergers and acquisitions, group and business restructuring, joint venture projects, intellectual property, franchising and distribution transactions, technical services arrangements and licensing, and financial products. He also assists clients in obtaining tax incentives. Mr. Tan also has extensive experience in tax dispute resolution. A member of the Middle Temple Inn of Court in England and Wales, Mr. Tan is also an Accredited Tax Advisor in the Singapore Institute of Accredited Tax Professionals.

Michael Nixon
Director of Economics (Transfer Pricing), Baker & McKenzie Wong & Leow, Singapore

An economist with 16 years of experience in transfer pricing consulting and academia, Michael Nixon's experience includes transfer pricing and business restructuring projects in the U.K., Germany, the Netherlands and Singapore, where he has been based for the last six years. He has advised multinationals across various industries throughout the planning, compliance and audit cycle. His practice is focused on transfer pricing controversy, intellectual property valuations and business restructuring. He is a member of the Singapore Transfer Pricing consultation group with the Inland Revenue Authority of Singapore (IRAS), and has undertaken training for the IRAS Tax Academy. He also consults with Singapore academic institutions on transfer pricing and business restructuring matters. Mr. Nixon has a Bachelor of Arts Economics degree from Nottingham Trent University and a Master of Science Economics (with distinction) from the University of London. He is a member of the Chartered Institute of Taxation in the U.K., and of the Society of Financial Advisors in the U.K..

Spain

Montserrat Trapé
Global Transfer Pricing Services, Partner, Tax Department, KPMG Abogados, Spain

Ms. Trapé joined KPMG in 2007 and has worked on numerous transfer pricing projects including transfer pricing policy design, documentation work, APA negotiations as well as audit defence and recourse in transfer pricing cases and international taxation. Her work has spanned the financial, consumer products, energy and pharmaceutical sectors.

Prior to joining KPMG, Montserrat Trapé worked at the Spanish Revenue Service. As Co-Director of International taxation she was responsible for negotiating several multilateral and bilateral APAs, judicial defence of TP assessments as well as actively participating in the new transfer pricing legislation. Ms. Trapé was also Vice-Chair of the European Union Joint Transfer Pricing Forum for four years. During this period, the JTPF worked on recommendations for the effective implementation of the Arbitration Convention, on a transfer pricing model documentation to simplify documentation compliance requirements and on a report on best practices for APA within Europe.

Montserrat Trapé is also a Visiting Professor at ESADE Instituto de Estudios Fiscales, where she has conducted several training courses for Spanish & Latin American Tax Authorities in Madrid. She is a frequent public speaker and contributor to articles and books on transfer pricing, dispute resolution mechanisms and international taxation issues.

Ms. Trapé has been included in the list of 2009 and 2010 "Best lawyers" in Spain.

Elisenda Monforte
Partner, Global Transfer Pricing Services, KPMG, Spain

Elisenda Monforte is a Partner in KPMG's Global Transfer Pricing Services practice. She joined KPMG in the U.S. in 2007, and has been part of the Spanish practice since 2011. Elisenda has extensive experience in the financial services industry, with a focus on banking and insurance, and funding transactions for non-financial clients. She has been involved in operational transfer pricing engagements, and analyzed the effective implementation of transfer pricing policies for IP licenses and services, as well as assisting clients in tax audits and the negotiation of APAs. Elisenda has been a lecturer both in internal training and external sessions at ESADE and Centro de Estudios Fiscales, and has co-authored a number of articles on the Spanish transfer pricing environment. She has also been a teaching assistant at NYU's Stern School of Business and College of Arts and Sciences. Elisenda is a graduate of Universitat Pompeu Fabra (BA in Law '05, BA in Economics '03) and NYU (MA in Economics '06).

Switzerland

Maurizio Borriello
Director, Transfer Pricing and Value Chain Transformation, PwC, Zürich,

Maurizio Borriello is a Director in the Transfer Pricing and Value Chain Transformation Team in Zürich, Switzerland. He graduated with a Bachelor of Arts in International Business from the University of Applied Sciences Aalen, Germany. Maurizio has been working in transfer pricing for almost ten years.

Michelle Messere
Consultant, Transfer Pricing and Value Chain Transformation, PwC, Zürich

Michelle Messere is a Consultant in the Transfer Pricing and Value Chain Transformation team based in Zurich, Switzerland. She graduated in Law and Accounting in Brazil and is an admitted attorney at the Brazilian Bar Association. She is currently studying the LL.M of International Contracts and Arbitration at the University of Fribourg, Switzerland.

United Kingdom

Murray Clayson
Editorial Board Member and Panelist for United Kingdom Tax Partner, Freshfields Bruckhaus Deringer, London

Murray Clayson is a partner in Freshfields' tax practice group and is based in London, and leads the firm's international transfer pricing practice. He specializes in international tax, finance and capital markets taxation, corporate structuring, transfer pricing, banking and securities tax, asset and project finance, derivatives and financial products, particularly cross-border. Murray is listed in *Chambers Europe, Chambers UK, The Legal 500 UK, Who's Who Legal, PLC Which Lawyer? Yearbook, Tax Directors Handbook, Legal Experts and International Tax Review's World Tax*. He is a fellow of the Chartered Institute of Taxation, past-Chairman of the British branch of the International Fiscal Association and a member of the CBI's Taxation Committee and International Direct Taxes Working Group. Murray is a graduate of Sidney Sussex College, Cambridge, and holds a PhD from the University of London for research in the field of transfer pricing. He joined the firm in 1983 and has been a partner since 1993.

Andrew Cousins
Director, Duff & Phelps, London, United Kingdom

Andrew is an international tax practitioner in the Duff & Phelps Transfer Pricing practice, with more than 18 years of cross-border experience in private practice, industry and in government. He brings a comprehensive regulatory, commercial and advisory perspective to the fields of transfer pricing and business restructuring, with a focus on practical implementation. Before joining Duff & Phelps Andrew was Deputy Comptroller of Taxes in the Jersey tax authority, acting as competent authority for all of Jersey's international tax agreements. He also served as Jersey's delegate to the Global Forum on Transparency and Exchange of Information for Tax Purposes, as well as representing Jersey at the OECD's Global Forums for Transfer Pricing and for Tax Treaties. Andrew spent eight years in industry as a global head of transfer pricing, and has led the transfer pricing practice in two FTSE 100 FMCG multinationals.

Andrew is a graduate of Oxford University and is an Associate of the Institute of Chartered Accountants in England and Wales. He qualified as a chartered accountant at Deloitte before focusing on transfer pricing at Ernst & Young, where he was a member of its Tax Effective Supply Chain Management team.

United States

Jeffrey S. Korenblatt
Reed Smith LLP, Washington, D.C.

Jeffrey S. Korenblatt is a tax attorney with more than 15 years of experience. He has a broad-based transactional tax practice and focuses on international tax planning and transfer pricing. Jeff delivers tax solutions to clients in multiple industries, including, but not limited to, manufacturers, retailers, franchisors, web-based providers of goods and services, and taxpayers in life-sciences industries.

Patrick McColgan
Duff & Phelps LLP, Atlanta

Patrick McColgan is a managing director in Duff & Phelps' Atlanta office and part of the transfer pricing team. He has a strong focus on assisting growth companies with their global transfer pricing needs through the design of defensible and pragmatic solutions. Patrick has more than 11 years of transfer pricing experience and has worked across several industries including automotive, chemical, consumer products, medical products, pharmaceutical, software, internet, and manufacturing.

Emily Sanborn
Duff & Phelps LLP, Altanta

Emily Sanborn is a director in the Atlanta office of Duff & Phelps' Transfer Pricing practice. Emily has more than nine years of transfer pricing experience and has both led and assisted in the design and implementation of practical and effective transfer pricing solutions to address a broad spectrum of transfer pricing issues, including management fees, license and migration of intangible property, and tangible goods transfers. Emily also has experience assisting clients throughout the transfer pricing lifecycle, from planning to documentation to litigation and arbitration support.

Transfer Pricing Forum Country Contributors

Country Contributors

Argentina

Cristian Rosso Alba
Rosso Alba, Francia & Asociados Abogados, Buenos Aires

Cristian Rosso Alba heads the Tax Law practice of Rosso Alba, Francia & Asociados. He has a well-recognized expertise in tax law, with particular emphasis on domestic and international tax matters. Mr. Rosso Alba has served as professor of Tax Law at the Pontifical Catholic University of Argentina; visiting professor at the University of Buenos Aires, School of Economics; professor of Tax Law at Austral University and professor of postgraduate courses at the Torcuato Di Tella University. Additionally, he has been a regular lecturer in the United States and speaker in domestic and international tax conferences and is the author of more than eighty articles appearing in specialized publications. Cristian Rosso Alba holds an LL.M from Harvard Law School, and a Certificate in International Taxation jointly from Harvard Law School and the J.F. Kennedy School of Government at Harvard; a Masters in Taxation from Buenos Aires University School of Economics; and the degree of Abogado from the University of Buenos Aires Law School. He is a member of the American Bar Association (ABA), the Canadian Tax Foundation and the Advisory Board of the Argentine Chamber of Commerce. He has been recommended as one of the "Leaders in their Field" (Tax – Argentina) by *Chambers Latin America*.

Matias F. Lozano
Rosso Alba, Francia & Asociados Abogados, Buenos Aires

Matías F. Lozano works at Rosso Alba, Francia & Asociados in Buenos Aires, Argentina.

Australia

George Condoleon
Director, Duff & Phelps, Australia

George Condoleon joined Duff & Phelps in May 2017 from Quantera Global. He is a director in the Transfer Pricing practice based in Sydney, Australia. He has over 19 years of experience in advising multinational companies on their transfer pricing compliance, structuring of cross-border trade and complex transfer pricing disputes, with a focus on financial transactions/treasury activities and financial services, including banking and capital markets, asset management and insurance. Previously, George was a director in the transfer pricing group of PricewaterhouseCoopers in Australia, during which time he had a one-year secondment to a leading financial services institution in Paris, France. George holds a Bachelor of Economics with Honours from the University of New South Wales.

Austria

Alexandra Dolezel
Tax Director at PricewaterhouseCoopers, Vienna

Alexandra Dolezel has been a Tax Director in the Vienna, Austria, practice of PricewaterhouseCoopers since 2011. There, she specializes in transfer pricing; international tax structuring and value chain transformation; and mergers and acquisitions. In addition, she is a lecturer on European Union tax law and comparative tax law at FH Campus Wien, the largest university in Austria. Prior to joining PricewaterhouseCoopers, she was Head of Corporate Taxes for Borealis AG, where she had overall responsibility for group corporate tax, including matters affecting tax risk management, transfer pricing and international structures. Ms. Dolezel received her education at the Vienna University of Economics and Business Administration, and she is also a member of the Austrian Chamber of Accountants.

Maria Vasileva
Consultant at PricewaterhouseCoopers, Vienna

Maria Vasileva workst in the Transfer Pricing practice at PwC in Vienna.

Belgium

Dirk van Stappen
Partner, KPMG, Antwerp/Brussels

Dirk van Stappen is a partner with KPMG and leads KPMG's transfer pricing practice in Belgium. He joined KPMG in 1988 and has over 28 years of experience in advising multinational companies on corporate tax (both domestic and international) and transfer pricing issues. He leads KPMG's transfer pricing practice in Belgium. Furthermore, Dirk is a former member of the EU Joint Transfer Pricing Forum (2002-2015).

Since 1996, Dirk has been a visiting professor at the University of Antwerp (Faculty Applied Economics, UA) teaching Tax to Master students. He has been named in International Tax Review's "World Tax –The comprehensive guide to the world's leading tax firms", Euromoney's (Legal Media Group) "Guide to the World's Leading Transfer Pricing Advisers" and Euromoney's "Guide to the World's Leading Tax Advisers."

He is a certified tax adviser and member of the Belgian Institute for Accountants and Tax Advisers and of the International Fiscal Association.

Yves de Groote
Director, KPMG, Antwerp

Yves de Groote is a LL.M from King's College London, MSc. HUB; he joined KPMG in 2004 and has over 10 years of experience in advising multinational organizations on transfer pricing issues. He has been involved in and conducted various tax planning and transfer pricing assignments, ranging from the preparation of European and global transfer pricing documentation (including functional and economic analyses and comparables searches), domestic and international transfer pricing audit defense to the negotiation of (uni-, bi- and multilateral) rulings and advance pricing arrangements (APAs).

Eugena Molla
Manager, Global Transfer Pricing Services, KPMG, Antwerp

Eugena Molla is a Manager in Global Transfer Pricing Services at KPMG Belgium.

Brazil

Jerry Levers de Abreu
Partner, TozziniFreire Advogados, São Paulo

Jerry Levers de Abreu is a Partner at TozziniFreire Advogados, Sao Paulo.

Lucas de Lima Carvalho
Tax Associate, TozziniFreire Advogados, São Paulo

Mr. Carvalho is a Tax Associate with TozziniFreire Advogados, São Paulo. In addition to his practice, he is a teacher and lecturer, and a frequently published author. He holds an LL.M. in International Taxation from New York University School of Law; an LL.M. in Corporate Law from the Instituto Brasileiro de Mercado de Capitais (IBMEC); an International Executive MBA from the Chinese University of Hong Kong; an MBA in Taxation from Fundação Getúlio Vargas (FGV), and an LL.B. (magna cum laude) from Federal University of Ceará.

Mateus Tiagor Campos
Tax Associate, TozziniFreire Advogados, São Paulo

Mateus Tiagor Campos is a Junior Associate at TozziniFreire Advogados, Sao Paulo.

Canada

Richard Garland
Partner, Deloitte LLP, Toronto

Richard Garland is a partner in the Toronto office of Deloitte. He is a Chartered Professional Accountant and has over 25 years of accounting experience focused in the area of corporate international taxation. Richard has assisted clients in all aspects of international taxation, with particular emphasis on tax treaty issues, cross border financing structures and transfer pricing. Over the past several years, Richard's work has been focused in the area of transfer pricing, and he has been repeatedly recognized in Euromoney's guide to leading transfer pricing practitioners. .

Inna Golodniuk
Senior Manager, Deloitte LLP, Toronto

Inna Golodniuk is a Senior Manager at Deloitte LLP, Toronto, Canada.

China

Cheng Chi
Partner-in-Charge for China and Hong Kong, KPMG, Shanghai

Based in Shanghai, Cheng Chi is the partner-in-charge of KPMG's Global Transfer Pricing Services for China and Hong Kong. Mr. Chi has led many transfer pricing and tax efficient supply chain projects in Asia and Europe, involving advance pricing arrangement negotiations, cost contribution arrangements, Pan-Asia documentation, controversy resolution, global procurement structuring, and headquarters services recharges for clients in the industrial market including automobile, chemical, and machinery industries, as well as the consumer market, logistic, communication, electronics and financial services industries. In addition to lecturing at many national and local training events organized by the Chinese tax authorities, Mr. Chi has provided technical advice on a number of recent transfer pricing legislative initiatives in China. A frequent speaker on transfer pricing and other matters, his analyses are regularly featured in tax and transfer pricing publications around the world i.e. International Tax Review). Mr. Chi has been recommended as a leading transfer pricing advisor in China by the Legal Media Group. Mr. Chi started his transfer pricing career in Europe with another leading accounting firm covering many of Europe's major jurisdictions while based in Amsterdam until returning to China in 2004.

Rafael Triginelli Miraglia
Senior Tax Manager, Global Transfer Pricing Services, KPMG, Shanghai

Rafael Triginelli Miraglia is a Senior Tax Manager with the Global Transfer Pricing Team of KPMG China and member of the firm's BEPS Center of Excellence. His practice focuses on design and implementation of transfer pricing systems, business restructuring advice, value chain analysis and planning and outbound investments.

Rafael is graduated in Law (Universidade Federal de Minas Gerais, Brazil, 2004) and has obtained the degrees of Master of Laws (Pontifícia Universidade Católica de Minas Gerais, Brazil, 2008) and LL.M. of Advanced Studies in International Tax Law (ITC-Leiden University, the Netherlands, 2011). He is a Transfer Pricing Lecturer at the ITC-Leiden University and has taught courses in Tax and Constitutional Law at Pontifícia Universidade Católica de Minas Gerais. Rafael is a member of the Brazilian Bar Association (Ordem dos Advogados do Brasil) since 2005.

Before joining KPMG China, Rafael worked between 2011 and 2015 as Tax Associate with a global law firm in the Netherlands and, prior to that, as Head of Tax with a Brazilian law firm.

France

Julien Monsenego
Partner, Gowling WLG

Julien Monsenego specializes in international taxation, tax treatment of M&A and restructurings. He assists French and foreign companies in their international investments as well as in the course of their tax audits and litigations. He particularly focuses on Life Science and R&D-intensive industries. He has extended practice of transfer pricing and has intervened for French and non-French groups in setting up intra-group flows, IP companies and business restructuring. Before joining Olswang, Julien Monsenego worked at Arthur Andersen International, Ernst & Young, Coudert Brothers and Dechert LLP. Mr. Monsenego is a member of the Paris Bar.

Camille Birague
Associate, Gowling WLG

Camille Birague is an associate in the Paris Tax department. Her practice extends to various areas of French tax law, such as providing French and foreign clients advice and litigations assistance on a variety of transactions including disposals, acquisitions, restructuring, financing and refinancing. She advises corporate and private clients with different needs, which can involve working closely with the other teams in the firm.

Guillaume Madelpuech
Principal, NERA Economic Consulting

Mr. Madelpuech is a Principal within the Transfer Pricing Practice of NERA Economic Consulting in Paris.

Germany

Alexander Voegele
NERA Economic Consulting, Frankfurt

For more than 25 years, Alexander Voegele has been advising international corporations and leading law firms on transfer pricing issues, specializing in the development of innovative economic structures for transfer pricing strategies and for the defense of major international transfer pricing cases. He has led hundreds of large transfer pricing projects and defense cases for a variety of clients in a range of industries. Prior to joining NERA, Dr. Voegele was a partner with PriceWaterhouse and KPMG, where he was in charge of their German transfer pricing practice. He holds a doctorate in economics and a Masters of Tax and Business Administration from the University of Mannheim. He is a certified German auditor and tax adviser and is a French Commissaire aux Comptes. He has received numerous awards as a transfer pricing adviser and has frequently been ranked as a leading tax and transfer pricing professional.

Philip de Homont
NERA Economic Consulting, Frankfurt

Philip de Homont specializes in complicated transfer pricing audits and the valuation of intellectual property for international corporations and law firms. He has defended major transfer pricing cases throughout Europe and the Americas in a wide range of industries from consumer goods to financial services. He holds a MSc in Economics from the University of Warwick and a Diplom (Masters-equivalent) in Physics from the Technische Universitat Munchen. Philip de Homont is the co-author of numerous articles and two books on transfer pricing and intellectual property valuation. He has participated in various transfer pricing conferences.

Georg Dettmann
NERA Economic Consulting, Frankfurt

Georg Dettmann is a Consultant/Manager at NERA Economic Consulting. He specializes in transfer pricing, company valuation and valuation of "hard to value" intangibles, credit valuation, computational analysis (econometric analysis, option pricing, Monte Carlo, DCF), and modelling economic circumstances (bargaining situations, market situation, political environment). He received his PhD in Economics from the Birkbeck, University of London.

Hong Kong

John Kondos
Partner, KPMG Global Transfer Pricing Services, Hong Kong

John Kondos is the Asia-Pacific Leader for Financial Services and the Financial Services Transfer Pricing team. He specializes in transfer pricing documentation, planning, controversy, and audit resolution matters, including competent authority negotiations. John has lived and worked in Asia for over 14 years, and has extensive experience with banking and capital markets, asset management, insurance, treasury and group service transactions in Japan, Korea, Hong Kong, Singapore, Taiwan and other Asian countries. He is a graduate of the University of Melbourne, and has a Bachelor of Commerce and Masters (Commerce & Business Administration) degrees from Kobe University in Japan.

Irene Lee
Director, KPMG Global Transfer Pricing Services, Hong Kong

Irene Lee has practiced tax for 11 years, the last 7 specializing in transfer pricing matters involving the financial services sector. She joined KPMG in Hong Kong in 2013, and advises banking, asset management, and insurance clients on transfer pricing policies, documentation, and risk management in the Asia region. She earned a Bachelors of Business Administration (B.B.A.) degree from the Chinese University of Hong Kong, and has studied at the University of North Carolina (Chapel Hill).

India

Rahul Mitra
Partner and National Head, Transfer Pricing & BEPS, KPMG India

Rahul K Mitra is currently the National Head of Transfer Pricing & BEPS for KPMG in India. Prior to joining KPMG India, Rahul was the national leader of PwC India's transfer pricing practice between 2010 and 2014. Rahul was a partner in the tax and regulatory services practice of PwC India between April 1999 and February 2015. Rahul has over 22 years of experience in handling taxation and regulatory matters in India. He specializes in transfer pricing, particularly inbound & outbound planning assignments, and advises on profit/cash repatriation planning; value chain transformation or supply chain management projects; profit attribution to permanent establishments, etc. Rahul independently handles litigation for top companies before the Income Tax Tribunals. At least 50 of the cases independently argued by Rahul have been reported in leading tax journals of India. Some of Rahul's major wins before the Tax Tribunals in transfer pricing matters have set precedents, both in India and globally.

In his personal capacity, Rahul has handled several APAs in India, involving clients from across industries; and also covering complex transactions, e.g. industrial franchise fees/variable royalties under non-integrated principal structures; contract R&D service provider model; distribution models, with related marketing intangible issues; financial transactions; profit split models for royalties; etc. He has been consistently rated as amongst the leading transfer pricing professionals and tax litigators in the world, by Euromoney and International Tax Review, since 2010.

Rahul has been a visiting member of the faculty of the National Law School in the subject of transfer pricing and international tax treaties, was the country reporter on the topic, "Non Discrimination in international tax matters", for the IFA Congress held in Brussels in 2008, and was invited by the OECD to speak in the 2012 Paris roundtable conference on developing countries' perspective on APAs.

Ireland

Catherine O'Meara
Partner, Matheson, Dublin

Catherine is a partner in the tax department at Matheson. Catherine has over ten years' experience advising multinational corporations doing business in Ireland on Irish corporate tax. Catherine has a particular interest in transfer pricing, competent authority matters and business restructurings and also has extensive experience in structuring inward investment projects, mergers and acquisitions and corporate reorganisations. Catherine's clients include many of the leading multinational corporations established in Ireland, primarily in the pharmaceutical, healthcare, ICT and consumer brand sector. Catherine has published articles in leading tax journals, is co-author on the Ireland section of the Bloomberg BNA TP Forum and is co-author of the Ireland chapter of the International Fiscal Association Cahiers on Cross Border Business Restructuring.

Catherine is a Chartered Tax Advisor and a member of the Law Society of Ireland.

Israel

Yariv Ben-Dov
Partner, Herzog Fox & Neeman, Tel Aviv

Yariv Ben-Dov is the Head of Transfer Pricing and Valuations Department at Herzog, Fox & Neeman. He is an expert in drafting and defending transfer pricing studies and intercompany agreements, with over 15 years of experience. Yariv counsels both multinational conglomerates and small start-ups on their transfer pricing matters, including multinationals which have no activity in Israel. Prior to joining HFN, Yariv was a co-founder of Bar-Zvi & Ben-Dov, a boutique law firm specializing in transfer pricing and high-tech, and prior to that Yariv served as the Head of the Transfer Pricing Unit in Teva Pharmaceuticals. Yariv has published articles in the subject of transfer pricing and has been asked to keynote as an expert in transfer pricing at several conventions in Israel, Europe and the U.S. Yariv is a member of Transfer Pricing Associates, the world's largest network of independent transfer pricing experts, a member of the Israeli Bar Tax Committee, and of the Board of the Israeli-LATAM Chamber of Commerce. Yariv is also a Board member of the Arthur Rubinstein Music Society and the head of the Society's NYC branch. Yariv counsels (pro bono) to the Israeli Navy Association. Yariv speaks Hebrew, English, French and Italian, and has often advised global clients in their local language.

Italy

Marco Valdonio
Partner, Maisto e Associati, Milan

Marco Valdonio was admitted to the Association of Chartered Accountants in 2002. He joined Maisto e Associati in 2000, after working for another tax law firm. He headed the London office from 2002 to 2004, and has been partner in the firm since 2011. Marco's areas of expertise comprise transfer pricing, tax controversies and settlements, mergers and acquisitions, financial instruments, and international taxation.

Aurelio Massimiano
Partner, Maisto e Associati, Milan

Aurelio Massimiano is a partner at Maisto e Associati, where he has practiced since 2005, after having worked for the International Tax Office of the Italian Revenue Agency, and prior to that, for a Big 4 accounting firm. His areas of expertise are international taxation and transfer pricing. He is the permanent assistant of Professor Guglielmo Maisto at the EU Joint Transfer Pricing Forum. A member of the Association of Chartered Accountants, he holds degrees from Luiss Guido Carli University in Rome, and an LL.M. in International Tax Law from the University of Leiden, The Netherlands.

Mirko Severi
Associate, Maisto e Associati, Milan

Mirko Severi joined Maisto e Associati in 2011 after obtaining a Master Diploma in Tax Law at IPSOA. He graduated (cum laude) in Economics from the University of Parma, in 2010. His areas of expertise include corporate taxation and group taxation.

Korea

Dr. Tae-Hyung Kim
Transfer Pricing, Korea

Dr. Tae-Hyung Kim is a former senior partner and national leader of the Global Transfer Pricing Group at Deloitte, Korea. Over more than 14 years, Dr. Kim has represented multinational corporations in various industries in transfer pricing audit defense, advance pricing agreement negotiations, mutual agreement procedures, and planning and documentation studies.

Prior to his previous position, Dr. Kim headed the national transfer pricing practice at other Big Four firm in Korea and the Law and Economics Consulting Group in Korea. Before specializing in transfer pricing, Dr. Kim was a research fellow for the Korea Institute for International Economic Policy (KIEP). During his tenure at the KIEP, he advised the Ministry of Finance and Economy, the Ministry of Commerce, Industry, and Energy and the Ministry of Foreign Affairs in the area of international trade and investment policies.

Dr. Kim' s recent publications appear in IBFD's International Transfer Pricing Journal, BNA Tax Management's Transfer Pricing Reports, and Euromoney's Transfer Pricing Reviews. His economics publications also appear in Canadian Journal of Economics and Review of International Economics.

He holds a Ph.D. in economics from the University of Washington and is a graduate of Advanced Management Programs of both Harvard Business School and Seoul National University.

Seong Kwon Song
Head of Transfer Pricing Group, Deloitte, Seoul

Mr. Seong Kwon Song, former Assistant Commissioner for International Tax Investigation and Head of the Competent Authority at the Korean National Tax Services (KNTS) leads the Deloitte transfer pricing group in Korea. The group has over 40 specialists including ex-KNTS officers and economists with global background.

Japan

Takuma Mimura
Managing Director, Cosmos International Management Co., Ltd, Nagoya

Takuma Mimura is Managing Director of Cosmos International Management, a transfer pricing boutique consulting firm in Japan. He has more than 14 years of transfer pricing experience, including 6 years at Deloitte Touche Tohmatsu (both Tokyo and New York), and international banking experience prior to transfer pricing. He has worked extensively on transfer pricing issues worldwide and is especially experienced in Japan, U.S. and China TP matters. He has also worked with a broad range of clients in manufacturing, financial services and telecommunications and has assisted many taxpayers in negotiations with the Japanese tax authorities on transfer pricing audit examinations. Takuma has authored articles for professional journals including BNA's Transfer Pricing Report and Monthly International Taxation of Japan, and is a frequent speaker on transfer pricing topics.

Luxembourg

Peter Moons
Tax Partner and Head of the Transfer Pricing Team, Loyens & Loeff, Luxembourg

Peter Moons is a partner in the tax practice of Loyens & Loeff Luxembourg since 2004, with a focus on corporate tax advice for multinationals and funds, in particular private equity funds, their initiators and their investors. Before joining the Luxembourg office in 2004, he practiced in the Rotterdam and Frankfurt offices of Loyens & Loeff, specializing in real estate funds and cross-border tax structuring. Peter is also active in the Loyens & Loeff German and Eastern European desks and heads the Luxembourg transfer pricing team. Peter is a member of the Luxembourg Bar, the International Fiscal Association (IFA) and of the tax committee of the Luxembourg Private Equity and Venture Capital Association. Peter is the author of Tax Management Portfolio, Business Operations in Luxembourg, published by Bloomberg Tax. He received a Business economics and tax law degree from Erasmus University in Rotterdam in 1996 and Tax law degree from University of Cologne in 1997.

Gaspar Lopes Dias
Tax Advisor and Transfer Pricing Specialist, Loyens & Loeff, Luxembourg

Gaspar Lopes Dias is an associate in the tax practice group of Loyens & Loeff Luxembourg. He specializes in international taxation and transfer pricing, Gaspar advises on financial transactions (e.g. cash pool, debt pricing) and on intra-group services. Prior to joining our Transfer Pricing team, Gaspar worked at a big 4 company in Belgium, having gained experience in several industries and in a broad range of transfer pricing matters, including TP documentation, IP structuring and arm's length license fees, relocation of functions, MAP/EU Arbitration Convention and EU State Aid rules on transfer pricing. He received a degree in Advanced Transfer Pricing from ITC Leiden, an advance LLM in European and International Taxation from Tilburg University, and a law degree from Nova University of Lisbon.

Fernanda Rubim
Tax Advisor and Transfer Pricing Specialist, Loyens & Loeff, Luxembourg

Fernanda Rubim is an associate in the International Tax Department of Loyens & Loeff Luxembourg. She specializes in International Tax Law and Transfer Pricing. Before joining Loyens & Loeff, Fernanda acquired six years of experience in International Tax Law and Transfer Pricing in the Industry. She received her LLM from the University of Leiden.

Mexico

Moises Curiel Garcia
Transfer Pricing Partner, Baker & McKenzie, Mexico City

Moises Curiel heads Baker & McKenzie's Latin America Transfer Pricing and Valuation practice in Mexico. He has more than 22 years of experience in transfer pricing and international taxes, and currently, among other aspects of his practice, tax counsel for the maquiladora industry and the Employers' Confederation of the Mexican Republic. He is recognized by International Tax Review as one of Mexico's top tax advisers. Mr. Curiel has previously served as the transfer pricing audits and resolutions administrator of Mexico's Ministry of Finance and Public Credit for almost eight years. He helped prepare and implement various transfer pricing rules in Mexico, including the Income Tax Law, the Temporary Tax Ruling and the Federal Tax Code. He also led the country's Advance Pricing Agreements Program and conducted the first transfer pricing audits in Mexico and in Latin America. He has represented Mexico before the OECD for the transfer pricing party (WP6). Mr. Curiel's educational certifications include degrees in public accounting from the Universidad ISEC in Mexico City and in taxation from the Universidad Panamericana, as well as certifications from Anahuac University (International Expert Transfer Pricing) and Instituto Mexicano de Contadores Puìblicos de Meìxico, A.C. (Tax Specialization Certificate).

Allan Pasalagua-Ayala
Tax Counsel, Baker & McKenzie, Mexico City

Allan Pasalagua-Ayala advises on transfer pricing, with an emphasis on economic analysis. He has considerable experience in matters involving planning, compliance, valuations and audits in Mexico. With over a decade of experience as an economist, Allan worked for over two years in the Firm's New York office, where he was involved in a large number of compliance and planning projects. Allan counsels companies from different industrial sectors on local transfer pricing matters but has also been involved in global and regional documentation projects. In particular, he advises on compliance with formal obligations, along with which best practices to establish transfer pricing policies, Advance Pricing Agreement procedures, and on the technical aspects on transfer pricing disputes. In addition, his practice includes business and intangible assets valuations. Allan received a Economics degree from Education Universidad Iberoamericana.

New Zealand

Leslie Prescott-Haar
Managing director, TP EQuilibrium | AustralAsia LP ("TPEQ")

Leslie is the managing director of TP EQuilibrium | AustralAsia LP ("TPEQ") (formerly, Ceteris New Zealand). TPEQ provides transfer pricing services in Australia and New Zealand, across an extensive range of industries, transactions and engagements, including APAs; independent second opinions and expert advice; tax authority reviews, investigations and audit defence; global, regional and country-specific documentation; etc. Leslie has over 22 years of specialised transfer pricing experience based in the APac Region (Sydney and Auckland), and an additional 10 years of corporate taxation experience in Big 4 accounting firm practices specialising in mergers, acquisitions, bankruptcies and reorganisations based in the United States (New York City and Chicago). Prior to forming TPEQ, Leslie commenced the transfer pricing practice of Ernst & Young New Zealand, where she served as the National Leader for a number of years. Leslie frequently provides 'thought leadership' contributions to various international publications and associations.

Sophie Day
Analyst, TPEQ

Sophie is an Analyst at TPEQ. She has over a year of transfer pricing experience since joining TPEQ in July 2015, working across various industries and projects for TPEQ's client base. Sophie completed her tertiary studies in 2016 and has since worked for the firm in a full-time capacity.

Stefan Sunde
Senior Analyst, TPEQ

Stefan is a Senior Analyst at TPEQ. He joined TPEQ in 2013 in a university internship role, and since such time has worked on major projects for most of the practice's major client base and all industries, and has managed some more recent projects. Stefan completed his tertiary studies in 2014 and has since worked for the firm in a full-time capacity

George Condoleon
Director, Duff & Phelps, Australia

George Condoleon joined Duff & Phelps in May 2017 from Quantera Global. He is a director in the Transfer Pricing practice based in Sydney, Australia. He has over 19 years of experience in advising multinational companies on their transfer pricing compliance, structuring of cross-border trade and complex transfer pricing disputes, with a focus on financial transactions/treasury activities and financial services, including banking and capital markets, asset management and insurance. Previously, George was a director in the transfer pricing group of PricewaterhouseCoopers in Australia, during which time he had a one-year secondment to a leading financial services institution in Paris, France. George holds a Bachelor of Economics with Honours from the University of New South Wales.

Russia

Evgenia Veter
Partner, Ernst & Young, Moscow

Evgenia Veter joined the Transfer Pricing Group of Ernst & Young as a partner in March 2011, coming from another major accounting firm. She has extensive experience in providing advisory services to Russian and international companies on various areas of taxation and conducting business in Russia, structuring investments, and coordinating approaches to tax planning. Since 2007 Evgenia has been focusing on transfer pricing. She has led transfer pricing planning and documentation projects for multinational and Russian clients in various industry sectors, including structuring of entry/exit strategies of clients from the transfer pricing perspective, adaptation of global transfer pricing policies to Russian requirements, business restructuring, development of sustainable transfer pricing methodologies, etc. Evgenia specializes on serving companies working in retail, consumer products and life science industries.

Timur Akhmetzianov
Senior Consultant in the Financial Services Transfer Pricing, Ernst & Young, Saint Petersburg

Timur Akhmetzianov joined EY Moscow in 2016. He provides transfer pricing and BEPS related services to financial service sector including banks, asset managers and insurance companies. He also provides corporate treasury and tax transfer pricing services to big multinational corporations.

Yuriy Mikhailov
Senior Manager in the Financial Services Transfer Pricing, Ernst & Young, Saint Petersburg

Yuriy Mikhailov joined EY Moscow in 2008. Yuriy provides Transfer Pricing and BEPS related services to financial service sector including investment banks, asset managers and insurance companies. He also provides Corporate TP Treasury services.

Singapore

Peter Tan
Senior Consultant (Tax and Transfer Pricing), Baker & McKenzie Wong & Leow, Singapore

Peter Tan leads the Baker & McKenzie Transfer Pricing practice in Singapore. He was called to the Bar of England and Wales in 1976, and started his tax career in London, continuing it in Singapore. Mr. Tan advises multinational companies from various industries on tax issues related to mergers and acquisitions, group and business restructuring, joint venture projects, intellectual property, franchising and distribution transactions, technical services arrangements and licensing, and financial products. He also assists clients in obtaining tax incentives. Mr. Tan also has extensive experience in tax dispute resolution. A member of the Middle Temple Inn of Court in England and Wales, Mr. Tan is also an Accredited Tax Advisor in the Singapore Institute of Accredited Tax Professionals.

Michael Nixon
Director of Economics (Transfer Pricing), Baker & McKenzie Wong & Leow, Singapore

An economist with 16 years of experience in transfer pricing consulting and academia, Michael Nixon's experience includes transfer pricing and business restructuring projects in the U.K., Germany, the Netherlands and Singapore, where he has been based for the last six years. He has advised multinationals across various industries throughout the planning, compliance and audit cycle. His practice is focused on transfer pricing controversy, intellectual property valuations and business restructuring. He is a member of the Singapore Transfer Pricing consultation group with the Inland Revenue Authority of Singapore (IRAS), and has undertaken training for the IRAS Tax Academy. He also consults with Singapore academic institutions on transfer pricing and business restructuring matters. Mr. Nixon has a Bachelor of Arts Economics degree from Nottingham Trent University and a Master of Science Economics (with distinction) from the University of London. He is a member of the Chartered Institute of Taxation in the U.K., and of the Society of Financial Advisors in the U.K..

Spain

Elisenda Monforte
Partner, Global Transfer Pricing Services, KPMG, Barcelona

Elisenda Monforte is a Partner in KPMG's Global Transfer Pricing Services practice. She joined KPMG in the U.S. in 2007, and has been part of the Spanish practice since 2011. Elisenda has extensive experience in the financial services industry, with a focus on banking and insurance, and funding transactions for non-financial clients. She has been involved in operational transfer pricing engagements, and analyzed the effective implementation of transfer pricing policies for IP licenses and services, as well as assisting clients in tax audits and the negotiation of APAs. Elisenda has been a lecturer both in internal training and external sessions at ESADE and Centro de Estudios Fiscales, and has co-authored a number of articles on the Spanish transfer pricing environment. She has also been a teaching assistant at NYU's Stern School of Business and College of Arts and Sciences. Elisenda is a graduate of Universitat Pompeu Fabra (BA in Law '05, BA in Economics '03) and NYU (MA in Economics '06).

Airam Gonzalez
Senior Consultant, Global Transfer Pricing Services, KPMG, Barcelona

Airam Gonzalez joined KPMG Abogados in September 2014.

Daniel Ruiz
Associate, Global Transfer Pricing Services, KPMG, Barcelona

Daniel Ruiz joined KPMG Abogados in September 2016.

Daniel Bourdages
Global Transfer Pricing Services, KPMG, Barcelona

Daniel Bourdages works ar KPMG Abogados.

Switzerland

David McDonlad
Partner, Transfer Pricing and Value Chain Transformation, PwC, Zürich,

David McDonald is a Partner at PricewaterhouseCoopers where he has worked since September 2009.

Ian Clarke
Director, Transfer Pricing and Value Chain Transformation, PwC, Zürich

Ian Clarke has been a director based in the Swansea office of PWC. He is part of the senior management team. He operates in the Assurance practice and work with clients on a whole range of business issues in the private and public sector. He works with a dedicated team that specialises in supporting private businesses, private clients and entrepreneurs through assurance, tax, consulting as well as corporate finance and transaction services advice.

Jean-Baptiste Massat
Consultant, Transfer Pricing and Value Chain Transformation, PwC, Zürich

Jean-Baptiste Massat is an Assistant Consultant in the Transfer Pricing and Value Chain Transformation Team in Zurich, Switzerland and an attorney admitted to practice in the State of New York. He graduated with an LL.M in American Law from Boston University School of Law and with a Master in International Taxation from Université Paris-Assas and HEC Business School.

United Kingdom

Murray Clayson
Editorial Board Member and Panelist for United Kingdom
Tax Partner, Freshfields Bruckhaus Deringer, London

Murray Clayson is a partner in Freshfields' tax practice group and is based in London, and leads the firm's international transfer pricing practice. He specializes in international tax, finance and capital markets taxation, corporate structuring, transfer pricing, banking and securities tax, asset and project finance, derivatives and financial products, particularly cross-border. Murray is listed in *Chambers Europe, Chambers UK, The Legal 500 UK, Who's Who Legal, PLC Which Lawyer? Yearbook, Tax Directors Handbook, Legal Experts and International Tax Review's World Tax*. He is a fellow of the Chartered Institute of Taxation, past-Chairman of the British branch of the International Fiscal Association and a member of the CBI's Taxation Committee and International Direct Taxes Working Group. Murray is a graduate of Sidney Sussex College, Cambridge, and holds a PhD from the University of London for research in the field of transfer pricing. He joined the firm in 1983 and has been a partner since 1993.

Xander Friedlaender
Trainee Solicitor, Freshfields Bruckhaus Deringer, London.

Xander Friedlaender is a Trainee Solicitor at Freshfields Bruckhaus Deringer LLP.

United States

Michelle Johnson
Managing Director in Transfer Pricing. Duff & Phelps LLP

Michelle Johnson has been practicing transfer pricing for over fifteen years. A managing director, Michelle has significant experience advising clients on transfer pricing and valuation matters, including global transfer pricing documentation preparation, ASC 740 (FIN 48) recognition and measurement analyses, intangible property valuation, and transfer pricing policy development. Michelle is a member of Duff & Phelps' financial services team and has significant experience assisting companies with pricing matters involving asset management, insurance, banking, and global dealing transactions. Michelle is also a frequent speaker on inter-company services transactions and has performed dozens of analyses in this area. In addition to preparing documentation, restructuring and planning assistance for companies ranging from start-ups to Fortune 100 firms, Michelle has been called upon as a transfer pricing expert in numerous audit defense matters. Michelle obtained her Master's degree in Economics from New York University and a BS in Economics and French, with a minor in Mathematics, from the University of Illinois (magna cum laude).

Leda Zhuang
Director in Transfer Pricing, Duff & Phelps LLP

Leda Zhuang joined Duff & Phelps in 2017 as a director in the Atlanta office and is part of the Transfer Pricing practice. Leda has assisted numerous multinational firms to evaluate and address their intercompany pricing matters for purposes of documentation, business restructuring and tax planning. She led the economic analysis for various client engagements related to Advanced Pricing Agreement ("APA") negotiated, tax controversy and intangible property valuation. Leda has developed her expertise in a broad spectrum of industries, including real estate, financial services, telecom and technology, pharmaceutical and fashion products. Leda has a Ph.D. in Economics from the University of Colorado, Boulder, and a B.A. in Economics from Renmin University of China. She is also a CFA charter holder.

Michael Berbari
Vice President, Duff & Phelps LLP

Michael Berbari joined Duff & Phelps in September 2013.

Zachary Held
Vice President, Duff & Phelps LLP

Zachary Held joined Duff & Phelps in July 2014.