

Where is the line between cash pooling policies and intercompany debt, with reference to the rates you set and the potential for disguised long term loans?

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WHAT ARE THE PRINCIPAL ISSUES?

- **WHO UNDERSTANDS CASH POOLING?**
 - REVENUE AUTHORITIES
 - OECD
 - COURTS
 - CORPORATE TREASURERS
- **WHAT ARE THE CONCERNS?**
 - BASE EROSION AND PROFIT SHIFTING
 - ARMS LENGTH ISSUES ON FACILITIES PROVIDED AND SYNERGIES UTILISED
 - METHODOLOGY
 - UNCERTAINTIES ABOUT FUTURE POLICY

REVENUE AUTHORITIES

- Parents of multinationals tend to be in 4 countries, the US, the UK France and Germany
- At present the US does not see the interest under check the box arrangements, the UK as a prospective tax haven may not care but France and Germany do
- Pressure from OECD on Governments not to act unilaterally but little notice taken eg UK's Diverted Profits Tax. Divergent interests mean often little consensus
- Often lack any commercial experience to understand criteria for establishing a cash pooling leader, risk assessment, and establishing loan rates and guarantee costs

OECD

- OECD Transfer Pricing Guidelines updated in July 2017 incorporates the BEPS actions 8,9 and 10
- OECD accepts the updated Guidelines need further amplification on intra group loans and a discussion draft for a new TP chapter on finance is now promised for early 2018
- OECD has indicated that it will concentrate on the lender side whereas many member states analyse the borrower side as did the Australian *Chevron* case – *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation* [2015] FCA 1092, [2017] FCAFC 62

OECD - 2

- OECD delay in publishing its views on intragroup loans together with comments about anticipated policy creating uncertainty
- OECD has been criticised by some practitioners for its possible methodology based on *Chevron*
- The BEPS additions to the Guidelines plan to analyse the lender side in an intragroup loan under Chapter 1 part D, the functional analysis of general application to all groups
- No consensus about risk adjusted return. OECD requires funder to exercise control, meaning decision making (risk management) and capacity (risk assumption)

COURTS

- Main decisions *Chevron* in Australia (treating the borrower as a part of a group), *General Electric* in Canada (on guarantees) and *ConocoPhillips* in Norway and *Bombardier* in Denmark (on cash pools)
- *Chevron* analysed the borrower subsidiary as a member of a group rather than as a stand alone bad credit risk – OECD has adopted the view of a borrower as a group member for credit analysis and the new TP Guidelines accept implied parental support with several examples which are likely to be expanded in the expected draft

The Questions

- **Where is the line between cash pooling policies and intercompany debt**
 - Cash pooling policies are likely to be developed and centralized at parent company or treasury level with a view to minimising external costs/maximising interest income using either actual pooling through a cash pool leader or notional pooling
 - Intercompany debt may arise through the provision of goods and services which may themselves be the target of a transfer pricing enquiry – payment terms are likely to be determined locally rather than centrally unless a treasury type system operates in which case there may be little difference between the two
 - Alternatively debt may arise on an *ad hoc* basis and some Revenue authorities may be expected to use BEPS to curtail it

The Questions (2)

- **Impact on rate setting policy**
 - Rate analysis must take into account risk and support through guarantees etc
 - The OECD draft will try to divide the synergy benefit from the bank accommodation of the pool among the members of the pool
 - In *General Electric* the Canadian Revenue tried to argue unsuccessfully that the parent subsidiary relationship itself established the necessary synergy so that a charge to the subsidiary was unnecessary
 - Intercompany debt charges are similarly under OECD Guidelines likely to be analysed in broadly the same terms taking risk and financial support into consideration. Charges should be determined on a recognised pricing basis and properly documented

The Questions (3)

- **Potential for disguised long term loan**
 - Whilst very much determined by facts and circumstances the centralised management of risk and liquidity by Cash Pooling is less likely to result in disguised long term loans. Revenue authorities are generally alert to the possibility of upstream loans as constructive dividends/earnings stripping techniques
 - Intercompany debt interest may not be fully deductible under measures to curtail earnings stripping or under BEPS/common consolidated corporate tax base

The Questions (4)

- **How might secondary adjustment fit in?**
 - OECD defines a secondary adjustment as a constructive transaction that some countries will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment. Secondary transactions may take the form of constructive dividends, constructive equity contributions, or constructive loans.
 - Half of the OECD countries who have so far reported say that they do make secondary adjustments in response to a primary adjustment. Austria, Bulgaria, Canada, Czech Republic, Denmark, Germany, Indonesia, Luxembourg, Netherlands, New Zealand, Nigeria, Peru, Slovenia, Spain, Switzerland, US

The Questions (4)

- **How might secondary adjustment fit in?**
 - Belgium, Brazil, Colombia, Croatia, Ireland, Japan, Latvia, Lithuania, Malaysia, Malta, Mexico, Russia, Singapore, Slovakia and the UK do not make secondary adjustments

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