International Tax Training 2020
Part II

WORLD TAX
TOP TIER FIRM
2020

Agenda

Part II: Transfer Pricing

- Transfer Pricing Developments
- OECD TP Guidelines Developments
  - Delineation of the actual transactions
  - Intangibles, including HTVI
  - New guidelines on financial transactions
- COVID 19

Transfer Pricing Developments

Trends and global observations

Transfer Pricing Developments

- New OECD TPG on financial transactions

- Increased focus on documentation
  - New TPG on Country-by-country reporting
    - Updated content of existing guidance and inclusion of several additional questions and sections
  - Implicit due to the 2017 update of the OECD TPG on delineation
    - Tax payer to document the actual conduct of the parties
  - Implicit due to the 2017 update of the OECD TPG on HTVI
    - Tax payer to document the information used to assess the ex ante pricing arrangement
      - E.g. financial projections and used probabilities of occurrence of foreseeable outcomes

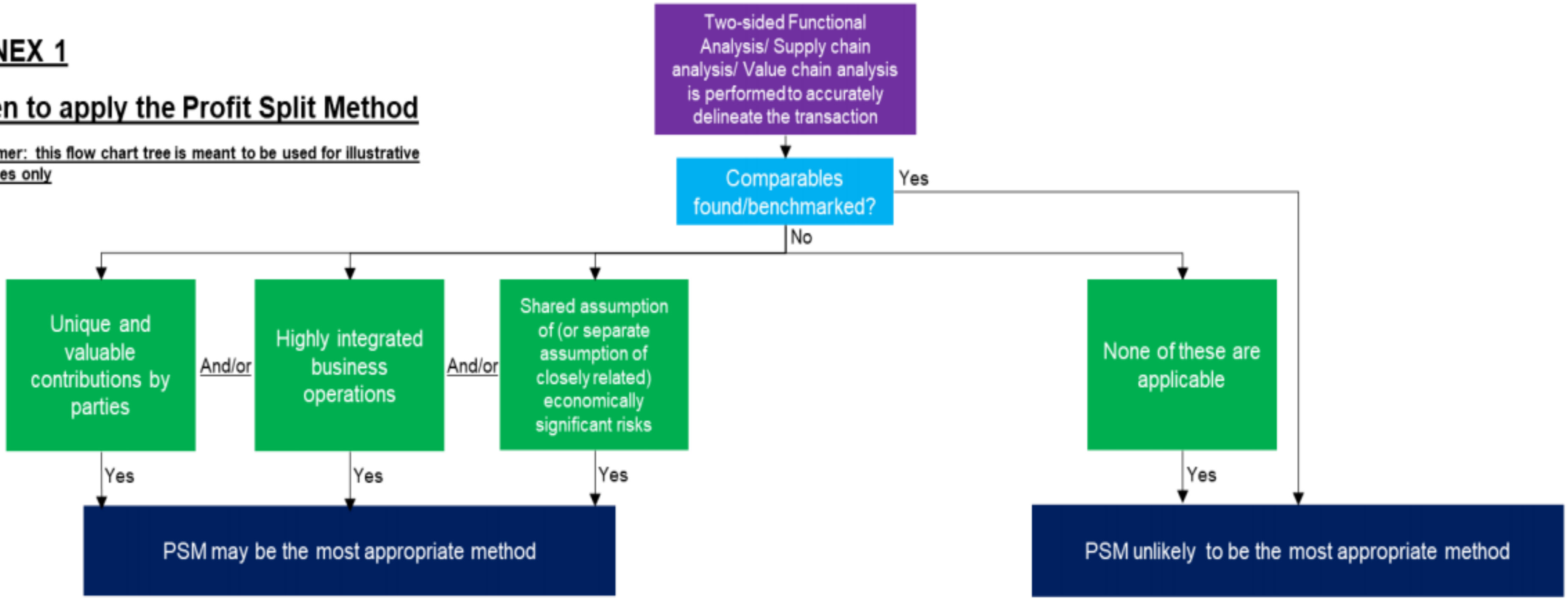
Transfer Pricing Developments

- Report on the application of the Profit Split Method within the EU
  - The European Union JTPF
    - Complementary and supportive to OECD TPG
      - Stage 1: Clarifying certain concepts related to the PSM
      - Stage 2 (to be conducted): Exploring ways for simplification
    - PSM may be a solution in cases where:
      - All relevant parties make <u>unique and valuable contributions</u> and/or there is a <u>high degree of integration</u>
      - Parties <u>share</u> the assumption of economically significant risks or <u>assume closely related risks</u>
      - Annex 1: Simplified flow chart tree of PSM selection process
    - How to split the profit
      - Annex 2: Simplified flow chart tree of a number of steps that may be considered when assessing when and how to apply PSM
      - Annex 3: Splitting factors and their pros and cons identified in the survey

ANNEX 1

When to apply the Profit Split Method

Disclaimer: this flow chart tree is meant to be used for illustrative purposes only



The following are *indicators* for whether the PSM may be the most appropriate method:

1. the existence of a unique and valuable contribution by *each party* to the controlled transaction; **and/or**

2. a high level of integration regarding business transactions to which the transaction relates; **and/or**

3. The shared assumption of economically significant risks by the parties to the transactions (or the separate assumption of closely related economically significant risks) by the parties to the transactions.[1]

It may not be not *appropriate to use the PSM:*

1. Where one of the parties to the transaction performs only simple functions and does not make unique and valuable contributions, **and/or**

2. The accurately delineated transaction can be appropriately benchmarked (even when the accurately delineated transaction is quite complex), comparable transactions can be identified;

N.B. The lack of comparables alone is insufficient for determining that the PSM should be selected as the most appropriate method; a pragmatic approach should be taken such as broadening the search criteria, without compromising the quality of the comparables, by looking at independent enterprises:

- with slightly different business strategies, business models or slightly different economic circumstances;
- situated in other geographical markets, but being active in the same industry; or
- engaged in different industries, situated in the same geographical market.[2]

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ANNEX 2

How to apply the Profit Split Method

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Contribution analysis [1]

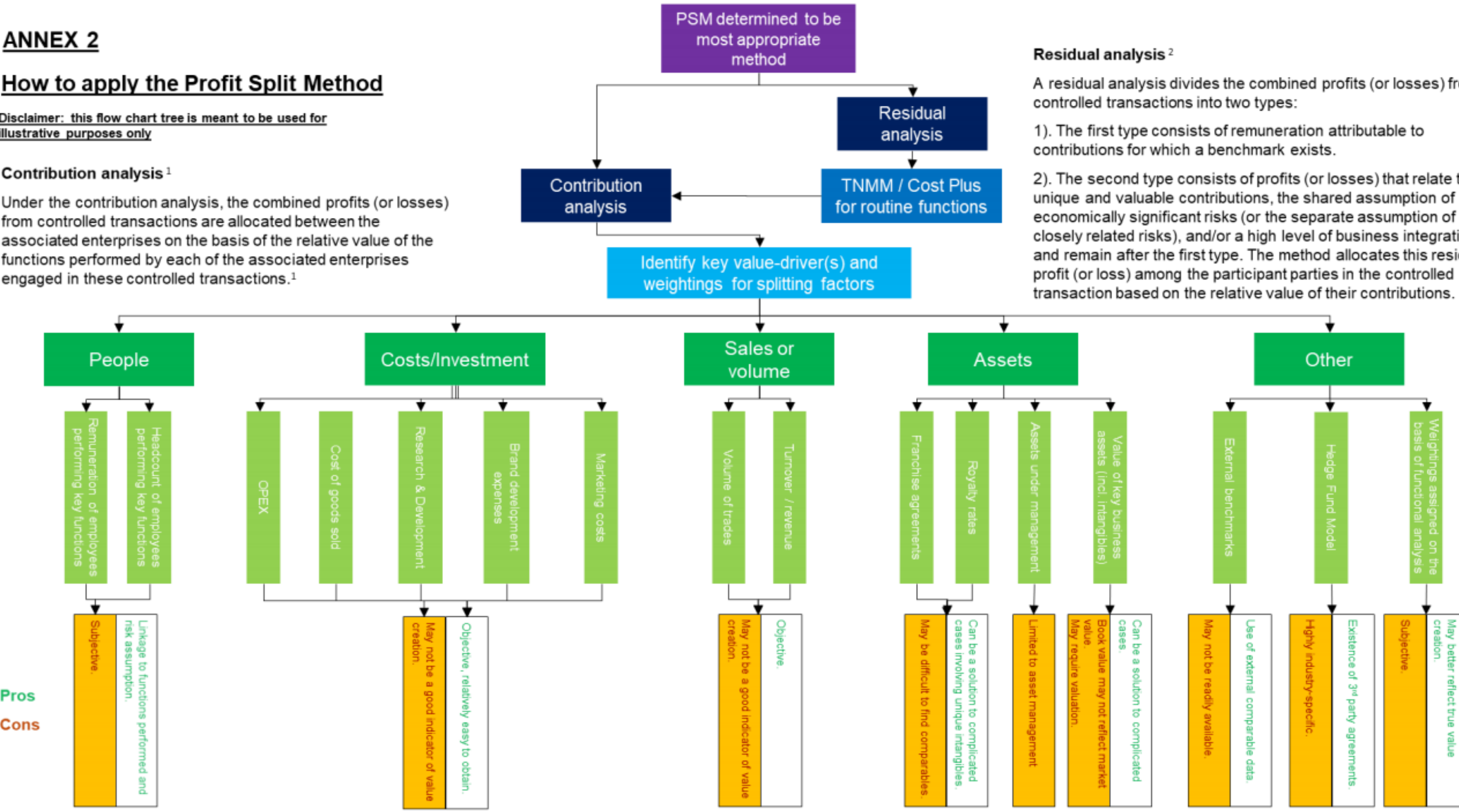
Under the contribution analysis, the combined profits (or losses) from controlled transactions are allocated between the associated enterprises on the basis of the relative value of the functions performed by each of the associated enterprises engaged in these controlled transactions.[1]

Residual analysis [2]

A residual analysis divides the combined profits (or losses) from controlled transactions into two types:

1). The first type consists of remuneration attributable to contributions for which a benchmark exists.

2). The second type consists of profits (or losses) that relate to unique and valuable contributions, the shared assumption of economically significant risks (or the separate assumption of closely related risks), and/or a high level of business integration and remain after the first type. The method allocates this residual profit (or loss) among the participant parties in the controlled transaction based on the relative value of their contributions.



OC: JTPF/002/2019/EN "EU Joint Transfer Pricing Forum – The Application of the Profit Split Method within the EU"

Transfer Pricing Trends

- Continued focus on TP as profit shifting

- EU State Aid Investigations and Court decisions
  - Alleged state aid to Nike
  - Alleged state aid based on Belgian “excess profit” tax scheme
  - The Netherlands and Starbucks v. Commission
  - Luxembourg and Fiat v. Commissions

- DAC 6 (Mandatory Disclosure rules) – Specific hallmarks on TP
  - The use of unilateral safe harbour rules
  - An arrangement involving the transfer of hard-to-value intangibles
    - Same definition as under the OECD TPG
  - Intragroup cross-border transfer of functions and/or risks and/or assets
    - if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer, are less than 50 % of the projected annual EBIT had the transfer not been made.

EU Developments

Did Netherland's APA grant selective advantage to Starbucks Manufacturing?

- **No** the EU commission cannot overrule MSs simply because it disagree with their selection of TP-method; even if there are methodological inconsistencies
- The EU Commission did not meet burden of proof demonstrating that the established tax liability deviates from a reliable approximation of market outcome

EU Developments

Did Luxembourg ruling to Fiat Finance confer a selective advantage?

- **Yes** ALP is a tool to examine whether stand-alone and integrated entities are treated equally
- TNMM accepted, but RoE as PLI applied to accounting equity not regulatory capital

Global observations

- Brazil: Adoption of the OECD standards
  - Current system: one-sided simplified approach
  - Way forward: immediate alignment vs. gradual implementation of changes
  - Status: input on design of safe-harbour provisions and other comparability considerations

- Several countries, e.g. Canada, Belgium and Germany adopts new legislation or domestic TP guidelines
  - To comply with the new TPG
  - To comply with the new guidance on financial transactions
  - CbC requirements

Delineation and recognition

A new TP approach?

OECD TPG (1995 and 2010)

- Recognition of the transaction
  - The TP examination should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them
  - Tax administration should not disregard the actual transactions or substitute other transactions for them
  - Can only be disregarded (and re-characterised) under exceptional circumstances:
    1. where the economic substance of a transaction differs from its form.
    2. where, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.

- The 2010 updates
  - In the new chapter IX on »Business Restructurings« it is stressed when »non-recognition« can be applied in regard to business restructuring

OECD TPG (2017)

- Recognition of the accurately delineated transaction
  - Non-recognition can be contentious and a source of double taxation
    - Ensure that non-recognition is not used simply because determining an arm's length price is difficult

- Can disregarded or substituted under exceptional circumstances:
  - Can not be disregarded if the same transaction can be seen between independent parties in comparable circumstances
    - The mere fact that the transaction may not be seen between independent parties does not mean that it should not be recognized
  - key question is whether the actual transaction possesses the commercial rationality of arrangements that would be agreed between unrelated parties under comparable economic circumstances
    - Does the arrangements, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner in comparable circumstances
    - Consider whether the MNE group as a whole is left worse off on a pre-tax basis since (indicate that the transaction viewed in its entirety lacks commercial rationality)

OECD TPG (2017) - Delineation

- New steps
  - Before making the comparability analysis, the substance of the commercial or financial relations between the parties should be identified and *the actual transaction should be accurately delineated*
    - Determine the actual nature of the transaction
    - Apply arm's length pricing to the accurately delineated transaction
    - Ensure that the accurately delineated transaction, replaces that actually adopted by the taxpayers should comport as closely as possible with the facts of the actual transaction undertaken whilst achieving a commercially rational expected result

- Delineation of the actual transaction involves
  - Establishing the characteristics of the transaction
    - Contractual terms
    - Functions performed, assets used and risks assumed, incl. how these functions generate value
  - The nature of the products transferred or service provided
  - The economic circumstances of the parties and the market in which the parties operate
  - The business strategies pursued by the parties

OECD TPG (2017) - Delineation

- Emphasis on ***the actual conduct*** of the parties and the other economically relevant characteristics of the transaction
  - Compare the transaction to other options realistically available to them
    - Does alternatives that offers a clearly more attractive opportunity to meet their commercial objectives exist?
    - May be assessed in the context of a broader arrangement of transactions

- ***Written contracts*** (still) provide the staring point for delineating
  - May reflect the parties' intentions
  - Contractual risk assumption vs. actual control over the risk and the financial capacity to assume risk
  - Clarification and/or supplementing the written contract
  - Inconsistencies between the written contract and the (economically) characteristics

- If no written contract exists, i.e. the transaction is not formalized
  - All aspects would need to be deducted from available evidence of the conduct of the parties

OECD TPG (2017) - Delineation

- The functional analysis
  - Focus on what the parties actually do and the capabilities they provide, incl. decision making
    - The actual contributions, capabilities and other features of the parties can influence the options realistically available to them
    - Fragmented activities

- Assumption of risks -> expanded guidance
  - The expanded guidelines on risks should not be interpreted as indicating that risks are more important than functions or assets
  - When contractual assumption of risk is inconsistent with the conduct of the parties and other facts

OECD TPG (2017) - Risks

- Control of risks
  - Not necessary to perform day-to-day management of risks (can be outsourced)
  - Exercise of control requires capability to perform decision-making functions
  - Capability and authority to decide to take on the risk and to decide whether and how to respond to the risks
  - Meetings organized for formal approval of decisions, minutes of board meeting etc. does not – in itself – demonstrate control

- Financial capacity to assume risks
  - Access to funding (e.g. to pay for risk mitigation and bear the consequences should risk materialize)

OECD TPG (2017) - Risks

- Allocation of risks
  - Allocation of assumption of risk – ex ante
  - Ex post reallocation of risk when risk outcome is certain is inappropriate
  - The form of remuneration cannot dictate inappropriate allocation
  - If multiple parties (actually) exercise control and have the financial capacity
    - Allocated to the party that exercise most control
    - Other parties performing control activities are then remunerated appropriately

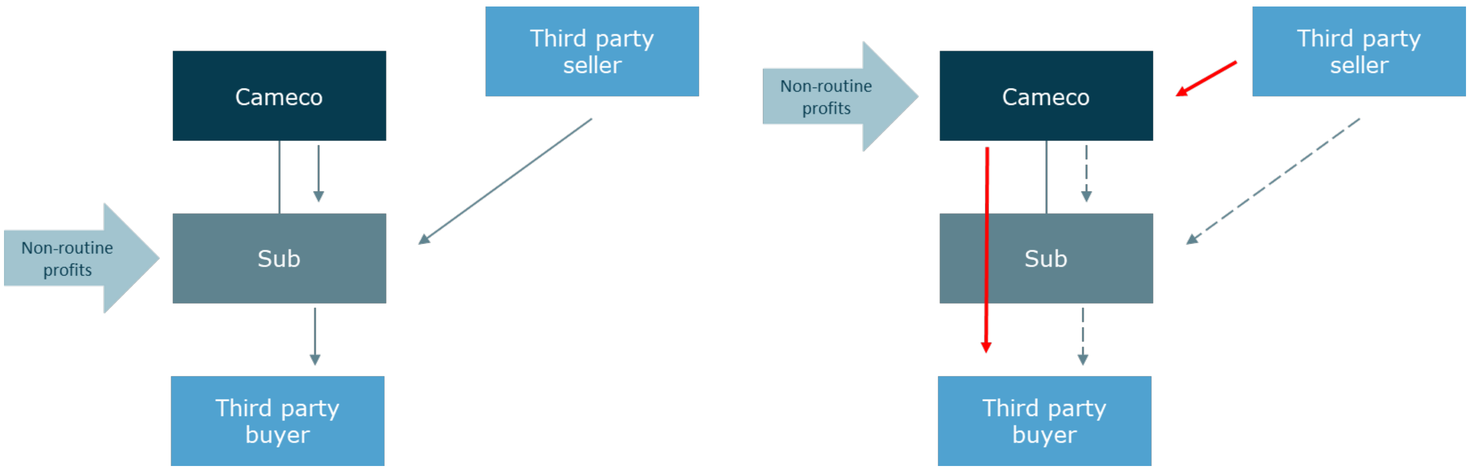
OECD TPG (2017)

- Pricing
  - Assumption of risk (allocated based on control and capabilities) is compensated with a risk adjusted return
    - The mere finance can only result in a risk-free return
    - The mere management of risk (outsourced) can only result in a risk-free return
    - Where a party contributes to control of risk (without assuming the risk), sharing of potential upside and downside may be appropriate

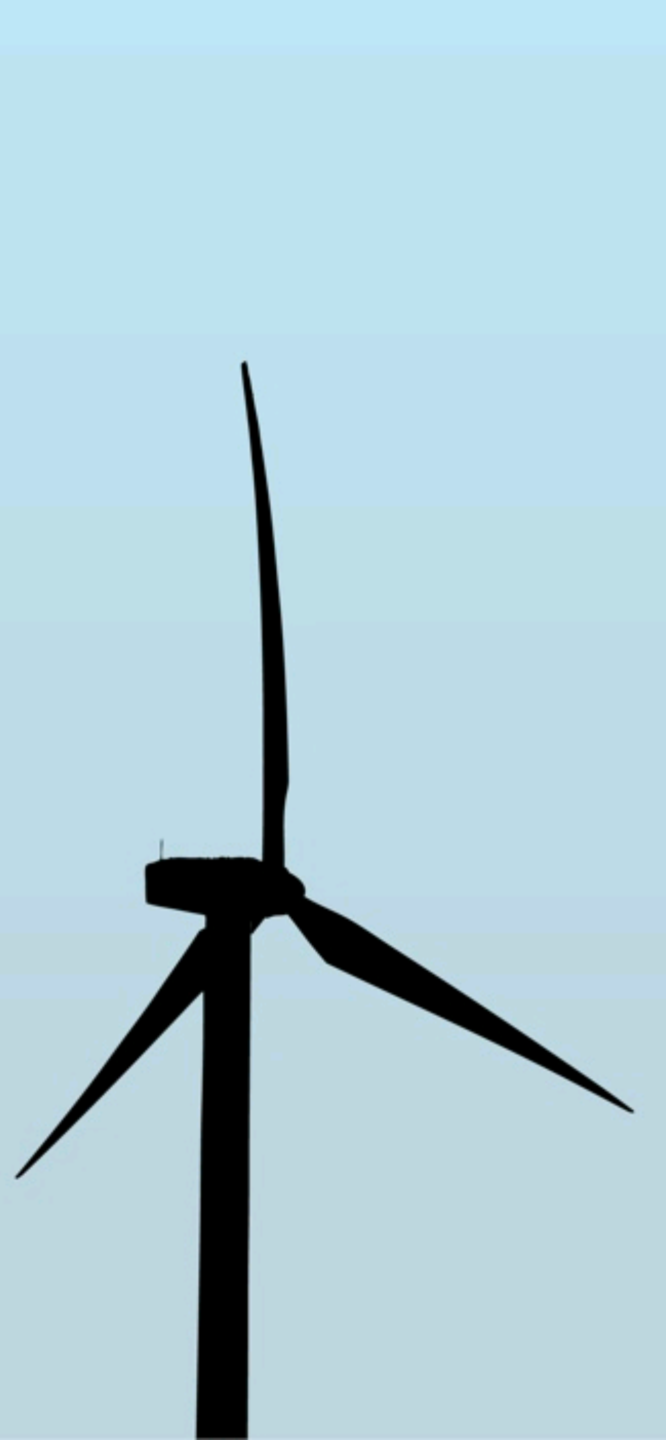
- Is this a new TP approach?
  - Delineation of the actual transaction
    - Emphasis on actual conduct
  - Pricing based on allocated risk as evidence for profits
    - Emphasis on actual control and capabilities

Cases

Non-recognistion of transactions



- CRA only permitted to substitute a transaction/structure in its entirety in very limited circumstances
  - "would not have been entered into between any two (or more) persons dealing at arm's length, under any terms or conditions"
  - Court sets a high bar for permissible non-recognition of transactions
    - Relied on the 1995 OECD TPG



Intangibles

Emphasis on HTVI

Identification of Intangibles

- Broad, independent definition of intangibles only for TP purposes:
  1. Not a physical or financial asset,
  2. Cable of being owned or controlled,
  3. Used in commercial activities, and
  4. Use or transfer would be compensated in a transaction between independent parties
- Compare to OECD Model Article 12:
  – *"The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."*

- IPR does not include market conditions, group synergies, assembled workforce and location savings etc.

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Returns from Intangibles

- Identification of group members that are entitled to returns from the exploitation of intangibles
- Legal owner test:
  - OECD now acknowledges that the legal owner is the owner of intangibles according to art. 9
  - Thus, in principle all returns derived from the exploitation of the intangibles may initially accrue to the legal owner
- Arm's length test:
  - Group members must be compensated for functions performed, assets used and risk assumed on an arm's length basis
  - More focus on significant people functions than on risk and capital
    - Regular functions
    - Important functions (significant functions)
  - To receive the total return on intangibles the legal owner must:
    - Perform and control all functions, including important functions
    - Provide all assets, including funding
    - Bear and control all risks

- Legal owner → economic owner → significant people functions
  - AOA developed for art. 7 will in fact be introduced in art. 9

Returns from Intangibles

- Identification of group members that are entitled to returns from the exploitation of intangibles under *joint development of intangibles*

- Arm's length test
  - Intangibles vs. other resources
  - Residual income should not automatically be allocated to the legal owner
  - Other factors have to be considered e.g.: i) risks, ii) market characteristics, iii) location, iv) business strategies and v) group synergies

- The profit split method
  - The preferred OECD method

- TNMM
  - Not a preferred method

HTVI – New Approach

- A new approach on HTVI is implemented in the 2017 OECD TPG
  - Based on BEPS 8 on measures for HTVI
  - The aim is to minimize the negative effects of information asymmetry
  - Should improve consistency and reduce the risk of economic double taxation

- General principle
  - The tax authorities can consider ex post outcomes as presumptive evidence about the appropriateness of the ex ante pricing arrangement
    - Such (ex post) evidence should be necessary to be taken into account to assess the reliability of the information on which the ex ante pricing has been made
  - If a HTVI has not been transferred at ALP tax authorities may adjust by taken into account contingent payments, adjustment clauses etc.

HTVI – New Approach

- This approach (on ex post information) cannot be applied if:
  i. The taxpayer provides:
     1. Details of the ex ante projections used at the time of the transfer to determine the pricing arrangements, *and*
     2. Reliable evidence that any significant difference between the financial projections and actual outcomes is due to:
        - Unforeseeable developments or events that could not have been anticipated at the time of the transaction, *or*
        - That the probabilities of occurrence of foreseeable outcomes were not significantly overestimated or underestimated.
  ii. The transfer of the HTVI is covered by an APA with the countries of the transferee and the transferor.
  iii. Any significant difference does not reduce or increase the compensation for the HTVI by more than 20%.
  iv. A commercialization period of five years has passed since the HTVI first generated unrelated party revenues for the transferee and any significant difference between the financial projections and actual outcomes were not greater than 20%.

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HTVI - Definition

- In short 'HTVI' covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises,
  - There is no reliable comparables, *and*
  - Valuation assumptions are highly uncertain, making it difficult to predict the level of the ultimate success of the intangible at the time of the transfer.
- HTVI may exhibit one or more of the following features:
  - Only partially developed,
  - Is not expected to be exploited commercially until several years,
  - Is integral to development or enhancement of other HTVIs,
  - Expected to be exploited in a manner that is special and projection is highly uncertain,
  - The HTVI has been transferred to an associated enterprise for a lump sum payment,
  - Developed or used in connection with a CCA type arrangement.

HTVI - Comments

- The aim of more certainty and less asymmetric information is not solved
  - Valuation of HTVI is always uncertain for both taxpayer and tax authority
    - The new approach changes the direction of information asymmetry in favor of the tax authority
  - Adjustment in the pricing of the HTVI may be at the discretion of the tax authority
  - The 20% bandwidth is arbitrary
    - Industry and specific characteristics is not taken into account.
  - The use of ex post outcomes is not (necessarily) consistent with business reality

HTVI - Comments

- Still (many) unclarified issues
  - Unclear how HTVIs are different from other transactions with no comparables
  - Is profit potential an HTVI, or an attribute of HTVI or something beside tangibles and intangibles?
  - What documentation is required to prove the reasonable nature of the valuation ex ante?
  - Timing issues:
    - Ex post outcomes may not even be available until years after the transaction and the audit window
  - Are the taxpayers themselves allowed to apply the ex post presumptive evidence to justify spontaneous adjustment?

Cases

Termination of royalty agreement -> lost profit potential

- The assessment of whether the restructuring triggered transfer of IPR should be based on
  - Actual conduct of the parties (profit split)
    - (external) royalties was split 50/50
  - Existing information prior to the restructuring (9.120)
    - Emphasis on the existing royalty agreement entered into
      - remuneration for build IPR related to the motor program
      - no documentation on the choice of 50/50 split

- (Economic) ownership of IPR was transferred and thereby lost profit potential
  - Follows from the TP documentation that the Danish entity had contributed to re-design and development of a motor type included as an integrated part of the motor program
  - Remuneration based on lost profit potential in the termination period is NOT sufficient

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Cases

Conversion of software sales company to commissionaire

- No shift in burden of proof (due to insufficient TP documentation)
  - Description of the restructuring was included in the TP documentation
  - A functional analysis was made pre- and after the restructuring
    - Not important that the "delineated transaction" by the tax authorities was not described
- It was proofed that the conversion (termination of distribution agreement) triggered transfer of valuable IPR (marketing intangibles)
  - To what extent would a fully-fledged distributor accept to be converted into a low risk distributor?(9.45-9.47)
  - Existing TP documentation
    - DK has built significant and valuable client relations and has exhaustive knowledge of the clients IT-systems and therefore needs
    - Considered a significant factor for ongoing profits
  - Existing clients renewed contracts are not entered into with DK -> transfer of clients (contractual rights) (9.67)
  - Remuneration should be based on expected (lost) profit potential in 10 years
    - Based on expected lifetime of clients (taking into account the business line)
      - The tax authorities: eternal/perpetual cash flow
      - Taxpayer: the expiration of the actual contracts (3-5 years)

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Cases

On 26 August, the Korean National Tax Service launched a TP audit on Netflix Service Korea

"Any deliberate attempt to avoid tax will be duly punished with a punitive tax of up to 60 percent of the previously imposed amount. A criminal complaint will be filed with the prosecution for further investigation."

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Financial Transactions
New Guidelines

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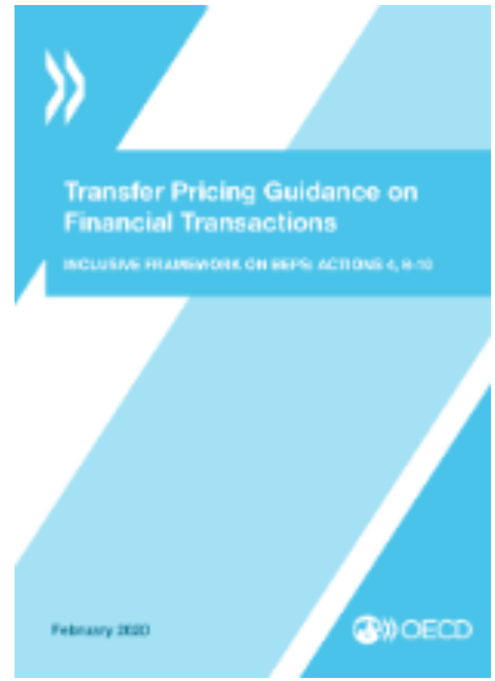
Financial Transactions

- Final guidance on transfer pricing aspects of financial transactions
  - Characterisation of loans - applying the arm’s length principle on intra-group loans
  - Risk-free and risk-adjusted rates of return
  - Treasury functions
  - Cash pooling
  - Financial guarantees
  - Captive insurance



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Intra-group loans - delineation

- Should purported loans be regarded as a loan?
  - Substance-over-form
    - Reclassification of debt to equity, if upon issuance it is clear that the debtor is unable to service the loan
    - Reclassification of a 10-year loan providing funding for short-term working capital to separate refreshed one-year revolver

- Indicators
  - Fixed repayment date; interests payments; enforcements rights; status compared to creditors; financial covenants and security; source of interests; ability of recipient to obtain loans from unrelated parties; funds used to acquire capital assets; and failure to repay on due date or to seek a postponement.

- Countries may have different views on the application of Article 9 to determine the balance of debt and equity
  - France, Sweden, Finland and Germany

Intra-group loans - delineation

- Identifying the commercial/financial relations
  - Factors affecting the performance of businesses
  - Use of MNE group's policies in delineating

- Economically relevant characteristics of the actual financial transaction
  - Contractual terms (written agreements and actual conduct)
  - Functional analysis
    - Allocation of risks
  - Characteristics of financial instruments
    - Important to consider whether absence of contractual rights over the (otherwise unpledged) assets of the borrowing entity reflect the economic reality of the risk inherent in the loan.
  - Economic circumstances
  - Business strategies

Intra-group loans - delineation

- Options realistically available to lender and borrower
  - All other options realistically available should be considered.
  - Only if no alternative offers a clearly more attractive opportunity to meet commercial objectives, independent parties will enter into a transaction.
  - Both the lender’s and the borrower’s perspective should be considered, and notably, the two perspectives may not align
    - Lender will carry on a credit assessment and consider methods to monitor and manage these risks.
    - Borrower seeks to optimize WACC and to have the right amount of funding available to meet both short-term needs and long-term objectives.

Intra-group loans – adjustments

- Comparability analysis and adjustments
  - Credit rating – based on quantitative and qualitative factors
    - Variances in creditworthiness between borrowers with same credit rating
    - Special circumstances
    - MNE group rating cannot per se be applied to specific entity
    - Publicly available tools are, generally, too simple compared to rating agencies.
- Effect of group membership – implicit support (passive association)
  - The relative status of the entity determines the impact of implicit support
    - Part of core business or strategically important
    - Consequences for the MNE group if not supporting
    - *G*eneral statement of policy/intent of support or history of support
- Incurrence covenants and maintenance covenants
  - Less information asymmetry in intragroup, i.e. less need for covenants.
- Guarantees
  - Only if the guarantor(s) would be able to meet any shortfall resulting from the borrower being unable to meet its obligations in full.

Intra-group loans – ALP

- CUP method
  - Easier to apply to financial transactions as high frequency and availability of information
  - A range of rates will be considered in accordance with the ALP
  - Arm’s length interest rates can also be based on the return of realistic alternative transactions with comparable economic characteristics, e.g. bond issuances, uncontrolled loans, deposits, convertible debentures, commercial papers
  - A comparable is not necessarily restricted to a stand-alone entity

- Credit default swaps (“CDS”) reflecting the credit risk linked to an underlying financial asset
  - In the absence of information regarding the underlying asset that could be used as a comparable transaction, the spreads of CDS may be used to calculate the risk premium.

Intra-group loans – ALP

- Cost of funds method (in the absence of CUP)
  - Reflects costs incurred by the lender in raising funds to lend, costs of arranging and servicing the loan, a risk premium, a profit margin generally including lender's incremental cost of the equity required to support the loan.
    - May be used to price loans where capital is borrowed from an unrelated party which passes from the original borrower through associated intermediary enterprises, as a series of loans, until it reaches the ultimate borrower.

- Economic modelling
  - Calculate an interest rate through a combination of a risk-free interest rate and a number of premiums

- Bank opinions or "bankability" opinion
  - Generally not regarded as evidence of arm's length terms and conditions.

- Loan fees and charges, e.g. arrangement fees or commitment fees on undrawn facility

Risk free and risk adjusted rates of return

Risk free rate of return

If funder lacks the capability, or does not perform the decision-making functions, to control the risk associated with investing in a financial asset, it will be entitled to no more than a risk-free return.

Typically the interest rate on certain government issued securities:

- Functional currency of the investor. If multiple countries issue bonds in the same currency, the government security with the lowest rate of return should be referred to.
- Issued at the same time, or have a similar remaining maturity.
- Duration should match.

Alternatively, interbank rates, interest rate swap rates or repurchase agreements of highly rated government issued securities could be applied.

Risk adjusted rate of return

If funder exercises control over the financial risk associated with the provision of funding, without the assumption of, including the control over, any other specific risk, it could generally only expect a risk-adjusted rate of return on its funding.

- Financial risk vs. operational risk

Potential methods:

- CUP.
- Realistic alternative investment, e.g. bond issuances or third-party loans.
- Add a risk premium to the risk-free return, based on information available in the market on financial instruments issued under similar conditions and circumstances.

Financial guarantees - delineation

- Accurate delineation of financial guarantees
  - *"A legally binding commitment on the part of the guarantor to assume a specified obligation of the guaranteed debtor if the debtor defaults on that obligation."*

- Economic benefit derived beyond passive association
  - The borrower can borrow on the terms that would be applicable if it had the credit rating of the guarantor.

- Effect of group membership (passive association)

- Financial capacity of the guarantor to fulfill (potential) obligations

Financial guarantees - ALP

- CUP method
- Yield approach (max fee)
  - Quantifies the benefit that the guaranteed party receives in terms of lower interest rates
  - Maximum fee; the difference between the interest rate with the guarantee and the interest rate without the guarantee but with the benefit of implicit support (and taking into account any costs)
- Valuation of expected loss approach
- Cost approach (min fee)
  - Quantifies the value of the expected loss of the guarantor or the cost of capital required to support the risks assumed by the guarantor
  - Minimum fee; that the provider of the guarantee will be willing to accept
- Capital support method
  - Identifying the amount of additional notional capital required to bring the borrower up to the credit rating of the guarantor.

Treasury functions

Generally, part of the process of making the financing of the commercial business as efficient as possible, i.e. usually a support and coordinating service to the main value-creating operation.

- Usually the higher strategic decisions is the result of policy set at group level rather than determined by treasury itself.

In other situations, the treasury may be found to perform more complex functions.

Another key concern regarding treasury activities is the identification and allocation of the economically significant risks.

Decentralized treasury

Each entity within the MNE group has full autonomy over its financial transactions, e.g. if multiple operating divisions operating in discrete industries, regional hub structures, or specific local regulations.

Centralized treasury

Centralized treasury has full control over the financial transactions of the MNE group, with entities within the MNE group responsible for operational but not financial matters.

Cash pools

A way of achieving more efficient cash management by bringing together the balances on a number of separate bank accounts, e.g. by:

- More effective liquidity management – reliance on external borrowing can be reduced or if surplus an enhanced return may be earned.
- Reduction in financing costs by eliminating the bank spread embedded in the interest which would be payable/receivable on a number of separate debit/credit account balances.

Physical pooling

The bank account balances of all the members are transferred daily to a single central bank account owned by the cash pool leader. Any account in deficit is brought to a target balance by a transfer from the master account to the relevant sub account. Depending on whether there is a surplus or a deficit after the members' accounts have been adjusted to the target balance, the cash pool leader may borrow from the bank to meet the net funding requirement or deposit any surplus.

Notional pooling

The bank notionally aggregates the various balances of members' accounts and pays or charges interest according to the net balance, either to a designated master account or to the members'. Typically, most functions are carried out by the bank and not the cash pool leader.

Cash pools - delineation

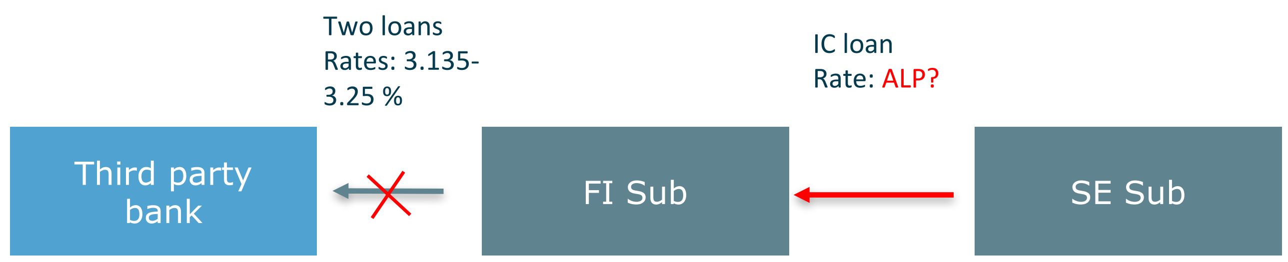
- Options realistically available should be considered for each member
  - Not undertaken by independent enterprises
    - Other benefits than improved interest rates can be obtained as a member of the cash pool
- Savings and efficiencies achieved are a result of group synergies
  - Advantage/disadvantage created through deliberate concerted actions
  - Benefit divided/shared by the members (provided that cash pool leader is otherwise appropriately remunerated).
- If debit/credit positions are maintained
- Economically significant risks associated to the cash pooling arrangement
  - Liquidity risk: Mismatch between the maturity of the credit and debit balances
  - Credit risk: Inability of members with debit positions to repay cash withdrawals
- A potential difficulty for tax administrations in analyzing cash pools is that the various members may be resident across a number of jurisdictions
  - Difficult to access sufficient information to verify the position as set out by the taxpayer.

Cash pools - ALP

- Rewarding the cash pool leader function
  - Coordination/agency function (limited remuneration)
- Rewarding the cash pool members
  - Interest rates on debit/credit positions - this should allocate the synergy benefits arising from the cash pool amongst the members.
    - All members will be better off than in the absence of the cash pool
- Cash pooling guarantees
  - Cross-guarantees and rights of set-off between members may be required.
    - Complex and may be practically impossible.
    - Could be regarded as implicit support.

Cases

Use of credit rating in the comparability analysis and adjustments



Average rate on all loans (incl. shareholder loans) in the Group: 9.5 %

Average rate on all external loans in the Group: 7.04 %

- The interest on the bank loan was considered the AL interest rate
  - The max. interest on IC loans is normally the rate paid to unrelated parties (CUP)
  - The credit rating should be based on the company on a stand alone basis
  - The lower credit rating on group level could not change this
    - In contrast to cases where the group has a better credit rating

COVID-19

Impact on Transfer Pricing?

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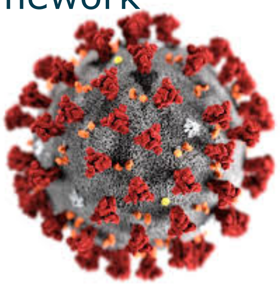
COVID 19

- The current pandemic has (obviously) not changed the legal framework for transfer pricing
  - What has changed is the factual circumstance
  - Exceptional situations leads to exceptional measures



- Increased need for finance
  - Delineation of group loans, i.e. debt or equity/contribution
  - New assessment of interest rates (on loans and used in Cash-pools)
    - Increased risk premium due to financial crisis of the group and/or the borrower

- Transfer/move of significant people functions
  - Due to termination of specific personnel and/or reorganizations due to winding up local presence
    - Must follow the ”known” principles
    - Can transfer of significant people/DEMPE functions result in exit tax?
  - Due to “home isolation” and travel bands
    - Is the transfer/move only temporary or can this effect the actual conduct of the parties on a permanent basis?

COVID 19

- Allocation of global loses to Low Risk Distributors/service providers
  - LRD are often remunerated on OM of X %
    - Based on low risk, i.e. no or only limited control and thereby assumption of risks
    - The remuneration is therefore low but fixed, i.e. no non-routine profits
  - Neither the principal nor the LRD have control over the Pandemic (and the risks involved)
  - Can any losses or lower profits be allocated to the LRDs?
- Must depend on, whether the lower profit/losses can be attributed to:
  - Principal
    - Risks controlled by the principal
    - General lower market demand
    - To a certain extent assumes the risk of force majeure
  - LRD
    - Local measures that hinder the LRD to perform its service, i.e. third party distributors does not continue to receive remuneration if the service is not performed
  - Reexamine the TP set-up (if the business is changed) and/or reexamine criteria used in the comparability analysis
    - New benchmarks could be conducted

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