OECD Chapter X

What's the impact of Chapter X on you?

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Introduction

In February 2020, the OECD released Chapter X of the OECD Guidelines. This was an important milestone in the transfer pricing landscape, as it was the first time ever that the OECD published guidance on the transfer pricing aspects of financial transactions. These guidelines, which form an **integral part of the OECD Guidelines as Chapter X**, aim to contribute to consistency in the interpretation of the arm's length principle in relation to financial intra-group transactions. They should also help avoid transfer pricing disputes and double taxation. Chapter X was part of the broader BEPS framework, whereby the OECD aims to tackle base erosion and profit shifting in a context of international taxation, and more specifically, action point 4 (i.e. *Limiting Base Erosion Involving Interest Deductions and Other Financial payments)* and action points 8-10 (i. e. *Aligning Transfer Pricing Outcomes with Value Creation)*.

During the months of February and March 2021, PwC Belgium conducted a survey on the impact of Chapter X. In total, 44 individual groups responded, which provided a decent sample to develop some key insights and conclusions. These key insights and conclusions are explained in this report.

Don't hesitate to contact us in case of any questions.

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Results at a glance

The recent developments regarding Chapter X and the transfer pricing aspects of financial intra-group transactions have inspired PwC Belgium's transfer pricing practice to investigate how this new OECD guidance has already impacted the transfer pricing policies of multinational companies. Have multinational companies already implemented changes in their transfer pricing policies? What are the main differences we see in the playing field one year after the introduction of the new guidance? And what will the future of financial transactions in a transfer pricing context bring? **Key observations and findings** were as follows.

The first part of the survey investigated the perceived importance of intercompany financing and tax controversy. We observed an **increasing focus on financial transactions during tax audits** over the past years. Following the publication of Chapter X, it is expected that tax authorities will focus even more on loan and cash pool transactions and especially the economic rationale (including debt quantum). As a result, it is more important than ever that taxpayers implement robust policies and documentation capturing the full transfer pricing analysis, starting from accurate delineation to effective pricing of the transactions.

The survey also focused on **long-term intercompany loans**. Here we see that robust documentation on the underlying business drivers, relevant terms and conditions as well as the allocation of risks between both contracting parties has become more important than ever before. We observed that such documentation is prepared by most of the respondents especially in regards to highly material transactions. Furthermore, it is clear that one year after the publication of Chapter X, the **best practice approach** for the estimation of interest rates reflecting creditworthiness of the borrower and impact of group affiliation, has **not yet fully been adopted** by all taxpayers.

Regarding **cash pooling** transactions, practice shows us that a cash pool leader often exercises functions which go way **beyond the remit of a mere service provider**. More particularly we clearly observed that in most cases the cash pool leader is deemed to actively managing the cash pool and related risks. Furthermore, the study shows that one year after the release of this guidance, taxpayers are looking into allocation of cash pool synergies. When such an analysis is performed, **cash pool synergies are generally allocated to the cash pool leader**.

Another point relating to cash pooling key take-aways is the importance of **robust legal frameworks and supporting documentation**. We observed that such robust documentation is not yet fully adopted by all respondents. A final key take-away concerns **negative interest** rates, and whether they are charged in an intercompany context. Almost **two-thirds of our respondents indicated that they floor** negative interest rates in cash pool participations.

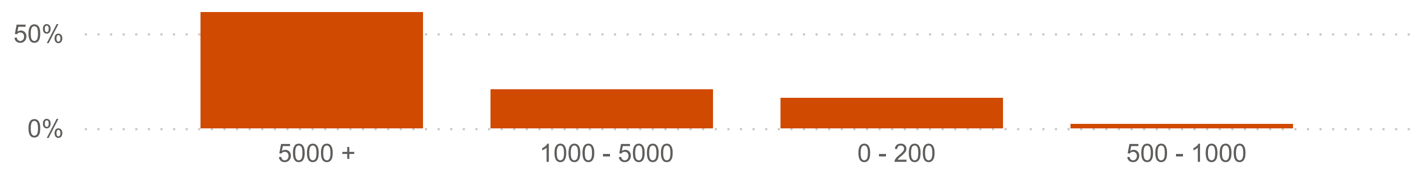
Looking at **hedging transactions**, the study revealed that financing entities generally decide autonomously whether or not to enter into hedging transactions. In such cases, hedging transactions are often carried out in their own name. For this reason, the hedging activities observed in the sample go mostly **beyond the sole provision of services** related to hedging transactions as put forward by the OECD. The new guidance therefore triggered no or limited changes to the policy on hedges.

Survey methodology

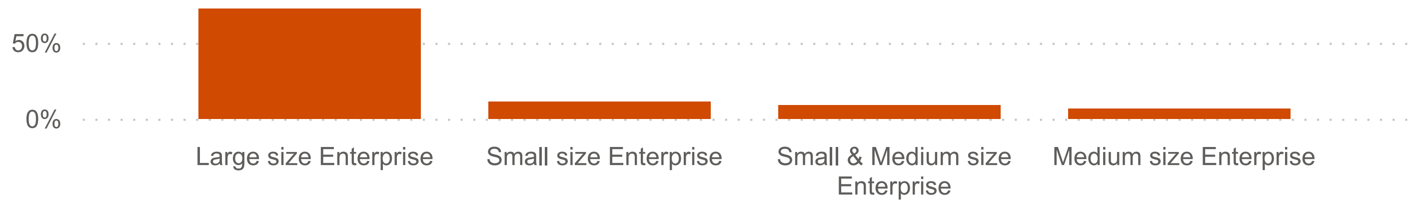
The majority of respondents were large multinational companies, active in a variety of industries. More than 50% of them have a consolidated turnover above 1 billion euros and more than 5,000 employees. The intercompany financing function of most of the respondents is located and centralised in Western Europe. Only a minority of the respondents have their financing function outside of Europe.

All respondents received an automated questionnaire which included questions on how they perceived the importance of intra-group financial transactions and their experience with tax audits. They also answered specific questions on the following types of intra-group financing transactions: (i) long-term intra-group loans, (ii) cash pool transactions, (iii) financial guarantees, (iv) hedging and (v) captives. These specific questions were only asked when such transactions were relevant for the respondent.

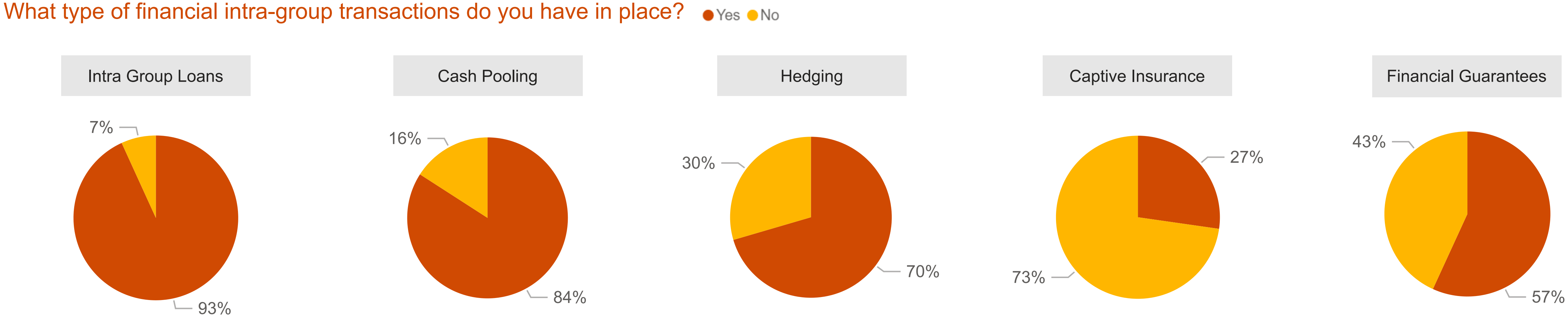
Consolidated number of employees



Size of the Group (turnover)



What type of financial intra-group transactions do you have in place?



Thank you

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