

**CIRCULAR**  
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**Subject:**  
**LAST REVISIONS ON OECD TRANSFER PRICING GUIDELINES**

It is widely known that the OECD provides both the taxpayers and Tax Administrations with significant guiding statements on transfer pricing practices and transfer pricing legislation practices through the Transfer Pricing Guidelines (Guidelines) it has published. Especially in recent years, many parts of the Guidelines were updated in accordance with the BEPS, the Base Erosion and Profit Shifting project. There are still some updates (intangible rights, profit split method) under way. For instance, relevant chapters on "hard-to-value intangibles" and "profit split method" practices in the Guidelines were updated in June 2018 in line with BEPS Action Plans 8 and 10.

There had been an agreement on that the narrowest scope of statements for taxpayers and Tax Administrations in the Guidelines were on financial transactions. Many discussion drafts sent to the OECD stated that the parts explaining the function analysis and methods for financial transactions should be elaborated on in detail and the OECD should bring forward some proposals. The OECD then released a discussion draft on the situation of Financial Transactions against transfer pricing on July 3, 2018. Opinions about this draft are expected to be sent to the OECD by September 7, 2018. The discussion draft contains remarks on the proper comparability analysis concerning such transactions as treasury, intra-group loans, cash pooling, hedging, guarantees and the application of transfer pricing methods, which are in line with the arm's length principle.

Highlights from the Discussion Draft are as follows:

**Intra-group loans**

- Not only the consistency of lending rates with the arm's length principle but also the capital structure of the borrower should be taken into account when intra-group loans are considered. At this stage, the Discretionary Capital and the transfer pricing legislation of the related country should be evaluated together. This evaluation needs to be multidimensional to determine whether the amount in question is a loan or a capital.
- Identifying the functions and risks of the parties is important in performing the comparability analysis and revealing the true nature of the transaction and the intra-group contracts need to be prepared in a way to reflect this nature.

- The following conditions need to be taken into consideration in the comparability analysis and in identifying the true nature of the transaction:
  - o The presence or absence of fixed payment dates
  - o The obligation to pay interest and principal
  - o The existence of financial covenants and security on the side of the lender
  - o The ability of the borrower to obtain loans from unrelated lending institutions (creditworthiness)
  - o Identification of whether the credit amount exceeds the credit strength of the lender and the creditworthiness of the borrower (The OECD welcomes comments and feedback on this matter in particular).
  
- In case the creditor doesn't have functions such as making decisions on the present loan transaction and risk management, it needs to be compensated at the prime interest rate referred to as "risk-free". However, the OECD did not indicate what the "risk-free" rate should be. Nevertheless, it is stated that "some" interests for low-risk government securities may be considered risk-free. The OECD did not mention the name of a specific state here, either. To eliminate currency risk, it is of utmost importance that the government security with the lowest rate is preferred when there are multiple countries issuing bonds in the same currency.
  
- The draft in question states that opinions are expected on what sort of a "credit rating" calculation should be made for the borrower based on the need to consider the group synergy when setting the intra-group lending rates.
  
- Once again, it highlights the fact that in cases where the loan is passed through more than one company, it would be more appropriate that the companies passing the loan determine the price based on the intermediary service costs instead of the "funding costs".
  
- It also states that the loan offers by the banks cannot be a valid benchmark because such offers do not completely reflect all terms and conditions of the transaction and are extended by the bank without conducting a complete loan analysis.

### **Cash Pooling Activities**

- The Guidelines clearly expressed that multinational companies can use cash pooling as an efficient, short-term cash management tool. This is a complex model which also contains related or unrelated (banks) persons. Thus, it shouldn't be considered as simply depositing into a bank and obtaining a daily deposit interest according to the OECD Guidelines. In other words, although the cash pool manages the daily cash flows, considering it as a long-term borrowing or deposit transaction would be more appropriate from the perspective of the parties. However, the difficulty in practice is that the calculation of the term is very challenging.
  
- The party managing the cash pooling activities (cash pool leader) should be indemnified only as a service provider when it has a coordinating function. This is elaborated on with examples in the draft.

## Treasury Activities

- Similarly, it is indicated that the enterprises functioning as treasury within the group are support units providing service in accordance with the policies set out by Group Management standards in general and, therefore, whether these companies have "value increasing" function within the scope of the arm's length principle should be assessed in detail.

## Guarantees

- The draft states that in the event where one of the group companies is the explicit guarantor of another, it may be subject to a compensation at the rate of the benefit such guarantee provides. It also explains the fact that the responsibility is not only based on the transfer pricing legislation but also has a legal basis and this necessitates such compensation especially where the other company is explicitly stated in the loan agreement.
- The key point in calculating the guarantor's fee is that the borrower should not be subject to a credit rating calculation over its own financial assets but, to the contrary, the indirect (implicit) impact of this company's existence on the group should be taken into account. Because when granting loans to companies, lending institutions take into consideration the positive impact of the group to which they belong even without the explicit guarantee of the parent company.

You can access the OECD sources mentioned in our circular via the web sites below.

<http://www.oecd.org/tax/transfer-pricing/BEPS-actions-8-10-transfer-pricing-financial-transactions-discussion-draft-2018.pdf>

<http://www.oecd.org/tax/transfer-pricing/guidance-for-tax-administrations-on-the-application-of-the-approach-to-hard-to-value-intangibles-beps-action-8.htm>

<http://www.oecd.org/tax/transfer-pricing/revised-guidance-on-the-application-of-the-transactional-profit-split-method-beps-action-10.htm>

Sincerely,

**DENGE İSTANBUL YEMİNLİ  
MALİ MÜŞAVİRLİK A.Ş.**

(\*) The remarks in our circular are for informational purposes only. We recommend that the opinion and support of a qualified counsellor be received before establishing final transactions on the questionable matters. Our company shall not be held responsible for any damages to be incurred as a result of transactions to be made solely on the basis of the statements in our circular.

(\*\*) For opinions, criticisms and questions about our circular, you can contact our specialists the contact information of whom is provided below.

**Gökçe GÜCÜYENER**  
**Head of Transfer Pricing**  
**Mazars/Denge Transfer Pricing Department**  
[ggucuyener@mazarsdenge.com.tr](mailto:ggucuyener@mazarsdenge.com.tr)