Working for your future ...wherever you are

WTS World Tax Service BV

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Loan pricing and financial structuring

Latest developments

- 2010 report on the attribution of profits to permanent establishments including section on banking.
- Increased focus of the tax authorities on the arm‘s length character of:
  - Loans
  - Interest
  - Guarantee fees
  - Cash pooling
  - Substance
- Increased focus of the accountant on the arm’s length character of financial instruments.

General

- Based on the OECD guidelines and various local transfer pricing rules, a company needs to substantiate the arm's length character of financial instruments used within the group.
- Appropriate transfer pricing documentation is required.
- European tax authorities become more knowledgeable on financial instruments.
- Pricing set by internal treasury departments often is insufficiently documented and substantiated.
- Bank quotes are not accepted by tax authorities to substantiate the arm's length character of a financial instrument, because:
  - It is a quote and not a deal (still open for negotiation);
  - It often comes from the house bank, lacking economic reality;
  - In many cases the quote is not approved by the internal credit committee of the bank and consequently is not a binding offer.

Costs of doing it wrong

- Tax adjustments including penalties and interest.
- In some countries penalties for lack of transfer pricing documentation.
- Possible, and often significant, double taxation.
- Substantial costs internally (management time) and externally (e.g. tax advisors) to get it right.
- Reputation risk

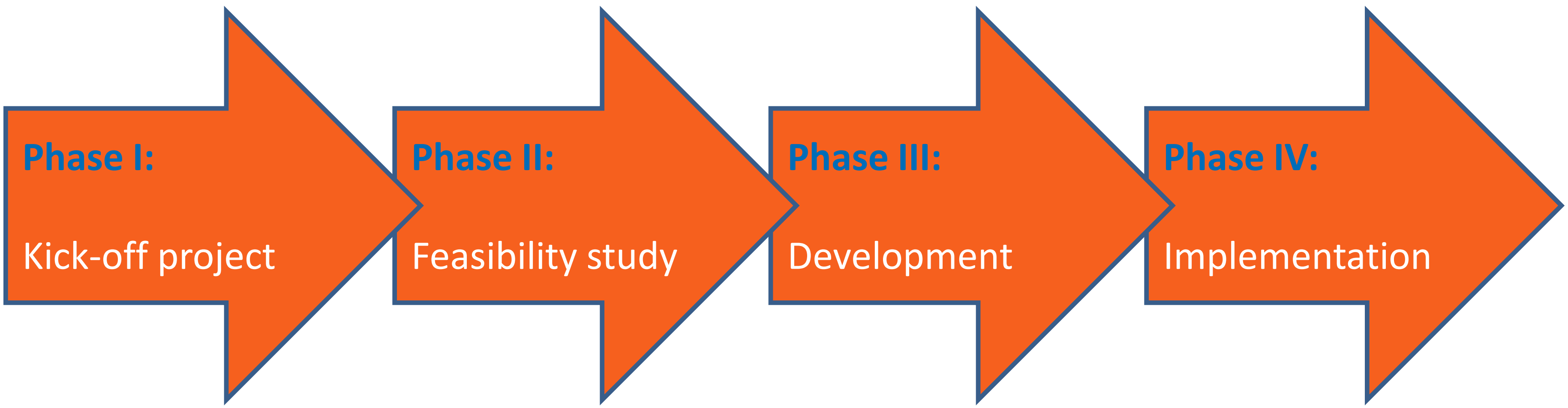
Opportunities

- The tax positions of the group companies can be optimized by changing the conditions of the intercompany financial transactions.
- Low tax jurisdictions could be introduced in the financing structure.
- Countries with special regimes for financing companies could be used (e.g. the notional interest deduction or special APA regimes).
- By imposing countries with good treaty networks (e.g. The Netherlands), withholding taxes can be reduced.
- Through hybrid loans "double dips" can be realised (deductible interest in one country, non-taxable dividend in another), while the hybrid loan commercially may be defined as equity (for a good debt-equity ratio).

➢ Substance requirements need to be met.

Project overview

- To minimize the risks and to optimize the opportunities, the following four step approach is recommended.



Phase I: Kick-off project

- Arrange for a kick-off meeting/conference call covering the following points:
  - (Envisaged) legal structure
  - Objectives
  - Scope
  - Project management
  - Roles & responsibilities
  - Approach
- Determination and gathering of the information required.

Phase II: Feasibility study

- Analyse the additional information provided.
- Address various issues such as:
  - Terms and conditions of the loans (e.g. hybrid loans)
  - Country benefits, such as the notional interest deduction and treaty benefits
  - Substance requirements
  - Guarantees and guarantee fees versus a credit default swap
  - Credit ratings
  - Subordination versus seniority
- Recommend final finance structure from a transfer pricing and tax perspective, taking into account the objectives set.

➢ The deliverable will be a presentation on the basis of which the way forward can be decided.

Phase III: Development

- Develop the agreed structure.
- Consider and implement the different financial conditions.
- Benchmark and determine arm's length interest rates:
  - Establish individual credit ratings of the group companies involved
  - Adjust the credit ratings on the conditions of the loans
  - Determine a range of arm's length interest percentages through a benchmark study
- Benchmark and determine guarantee fees:
  - Analyse interest differences between corporate credit ratings.
  - Analyse market information on credit default swaps.
- Validation of the structure from a local country perspective in the WTS network.

Phase IV: Implementation

- The structure developed in phase III will be implemented through legal agreements drafted by lawyers and the companies involved.
- Transfer pricing documentation supporting the structure and pricing is drafted.
- After the implementation, the terms and conditions and substance requirements need to be monitored.

Why WTS?

- WTS is equipped with a worldwide network of tax and transfer pricing specialists (in more than 90 countries)
- WTS has a banking team in Frankfurt and Rotterdam specialised in financial instruments.
- WTS uses the databases generally used by transfer pricing specialists worldwide to benchmark financial instruments:
  - Bloomberg
  - Thomson Reuters' Loan Connector and DealScan
  - Standard & Poor's Credit Risk Tracker

WTS Transfer Pricing Network

- Transfer pricing and tax experts all over the world that are used to interact with each other on international projects (see www.WTS-Alliance.com).
- Constitutes a global resource pool for cross-border TP projects.

Information request

- To prepare for the Kick-off meeting, please provide the following information:

Information needed	Available	Please provide
Overview of the current (and future) group structure		X
Offering memorandum (if applicable)		X
Valuation reports of the companies involved (if available)		X
Terms and conditions of the relevant loans		X
Information on the external debts of the group		X
Annual accounts of the relevant group companies		X
Tax returns of the relevant group companies		X
Information on the qualification of the board members of the Dutch financial service company (if applicable)		X

Contact details

When you have any questions or would like to have our advice, please contact:

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