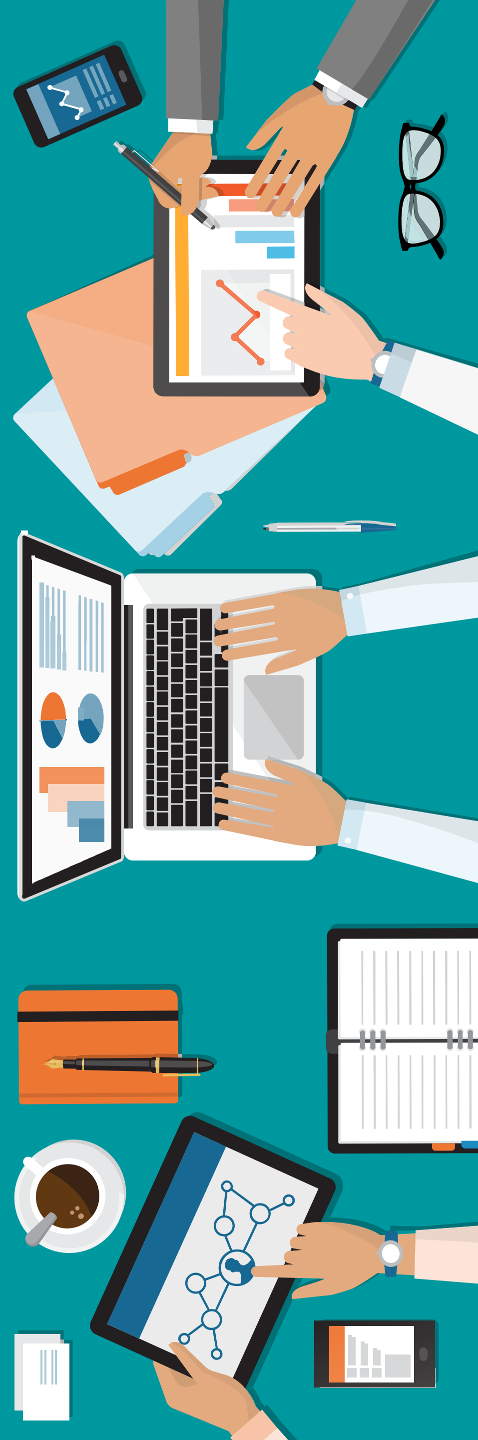
Financial transactions TP and the future of the UK's CFC Finco exemption

5 December 2018



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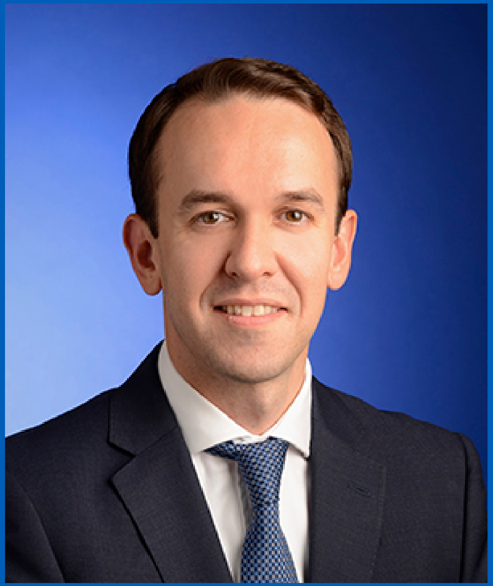

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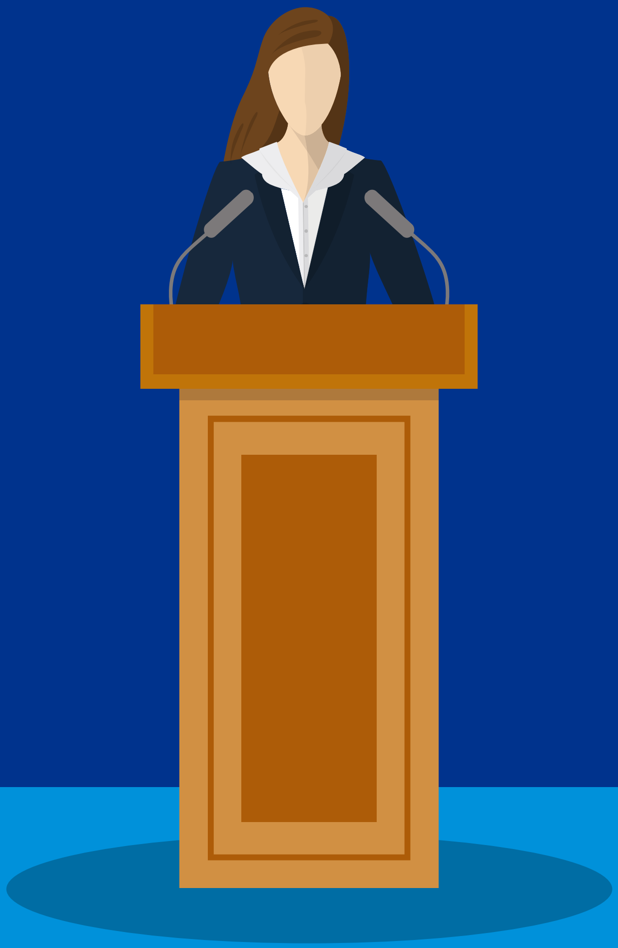
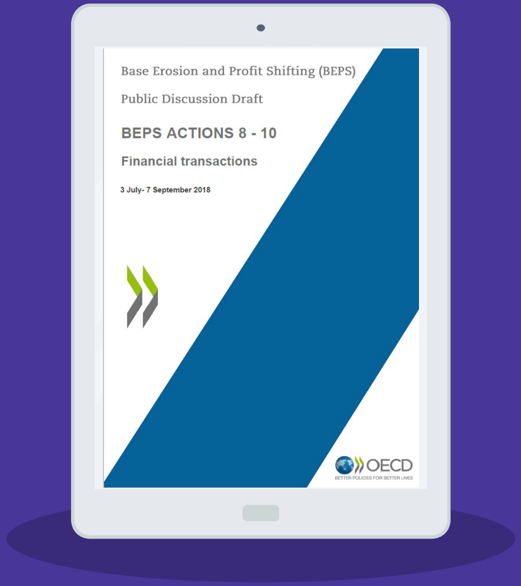
Agenda

1. OECD financial transactions discussion draft
2. Changes to UK CFC rules and impact on Fincos
3. TP considerations when refinancing
4. Questions



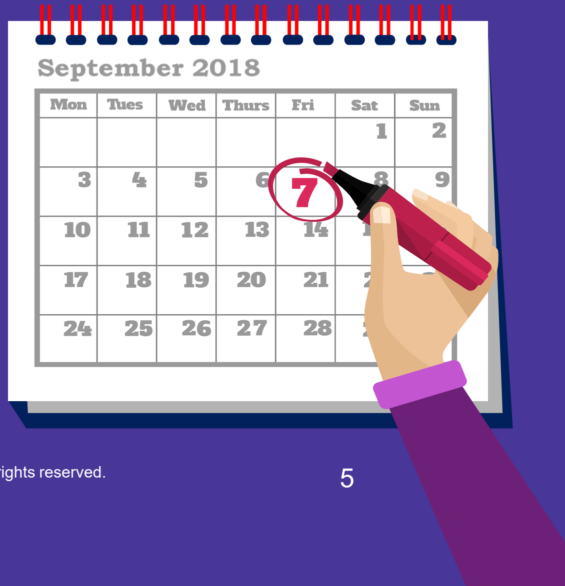
OECD financial transactions discussion draft



Financial transactions discussion draft: timeline and next steps

2018

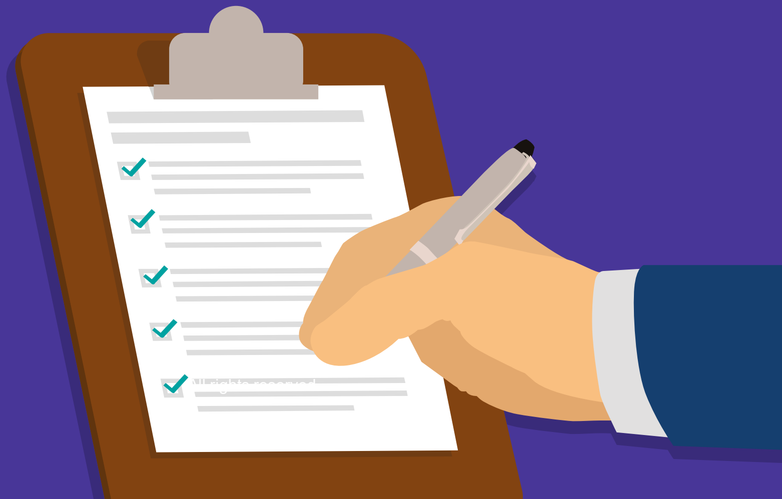
- **3 Jul** — Discussion draft released
- **Summer 2018** — Conversations with HMRC
- **7 Sept** — Deadline for comments
  - HMRC noted this was one of the most-responded-to OECD discussion drafts on TP
- **Nov/Dec** — Working party 6 meeting
  - KPMG aiming to meet with HMRC following WP6 meeting
- **Spring 2019** — Publication of another OECD discussion draft or OECD Guidance?



Financial transactions discussion draft: overview

Key topics discussed in the draft can be broken down into three areas:

- Application of the principles contained in the OECD Guidelines to the transfer pricing of financial transactions, with focus on the **accurate delineation of financial transactions**, **two sided analyses**, the consideration of **implicit support**.
- Guidance on the economically relevant characteristics that should be considered when analysing certain financial transaction.
- Specific transfer pricing issues related to treasury functions, intra-group loans, cash pooling, hedging, guarantees and captive insurance.



What we are seeing

Cash pooling:

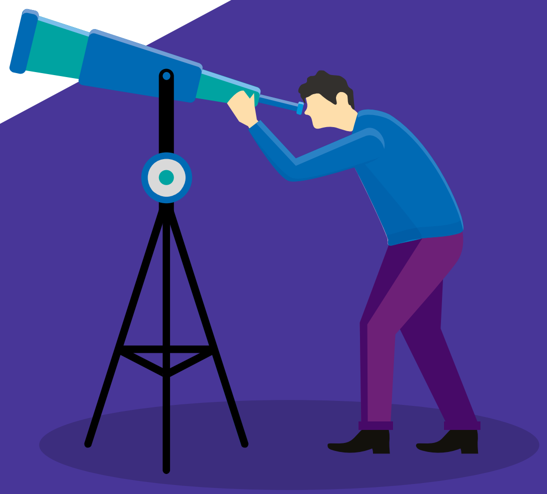
HMRC questioning appropriateness of cash pools (e.g. structural debt, persistent deposits)

Implicit support:

HMRC and other tax authorities challenging rates in excess of the group

Loan pricing:

HMRC challenging clients in a more structured and sophisticated manner (e.g. quantum of debt, interest)



Changes to UK CFC rules and impact on Fincos

EU ATAD and the UK CFC rules

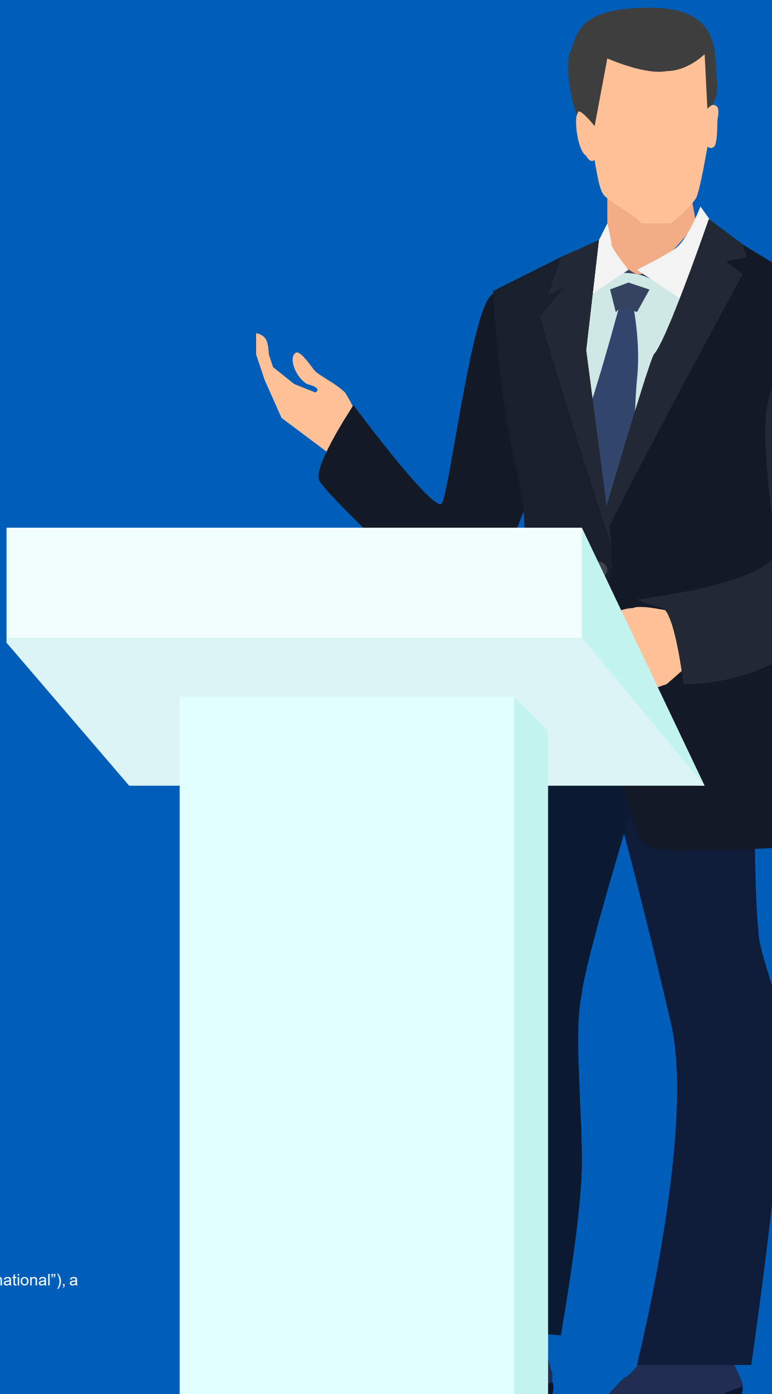
— The EU Anti Tax Avoidance Directive (“ATAD”) comes into force with effect from 1 January 2019.

— Two articles affect CFCs:

(i) definition of control, and

(ii) UK Significant People Functions (“SPFs”).

— The Finance Bill 2018-19 contains legislation that ensures that UK CFC rules are fully compliant with the ATAD.



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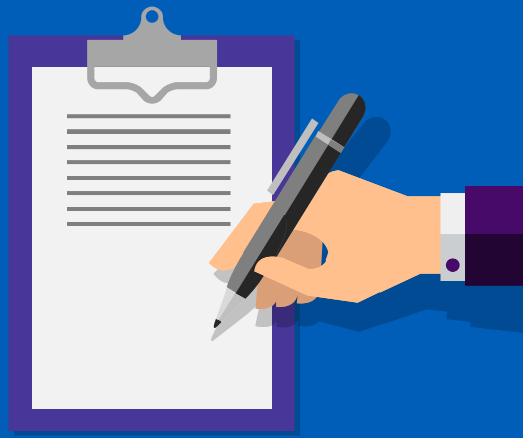
UK CFC rules and SPFs: overview of rules

Current rules

- Non-trading finance profits within scope.
- Chapter 9 Finco exemption.
- SPF analyses were therefore not necessary

New rules being introduced by Finance Bill 2019

- Finco exemption no longer available for non-trading finance profits arising from UK SPFs.
- Impact:
  - Groups with existing Finco structures should revisit the SPFs for each loan balance that exists on 1 Jan 2019.
  - Groups looking to implement new Finco structures or refinance existing structures need to undertake detailed SPF analyses.



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UK CFC rules and SPFs: SPFs definitions

UK legislation

TIOPA 2010, Chapter 4, Section 371DA(3f) and Section 371DB:

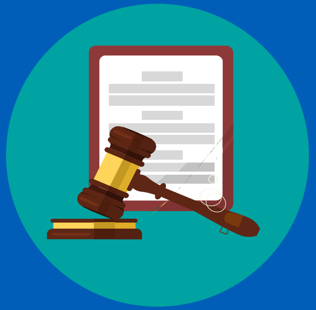
— Profits charged under the UK CFC rules are those where profits can be attributed to UK SPFs.

— SPFs are defined as a “significant people function or a key entrepreneurial risk-taking function” (Section 371DA).

— Profits are to be attributed in accordance with the “principles set out in the OECD Report” (Section 371DB).

UK CFC rules and SPFs: SPFs definitions (cont'd)

OECD guidance



"Report on the Attribution of Profits to PEs" published on 22 July 2010:

— Same SPFs relevant both to the assumption of risk and economic ownership of assets in the context of financial assets.

— There is no specific guidance for SPFs in the context of intra-group non-trading finance profits.

— For trading finance profits, key functions highlighted include;

- negotiating the contractual terms of the loan including the pricing;
- deciding whether or not to advance monies;
- evaluating the credit, currency and market risks;
- establishing the creditworthiness of the borrower; and
- reviewing resulting risk exposures and deciding whether to accept or mitigate these risks through hedging for example.

UK CFC rules and SPFs: SPFs definitions (cont'd)

HMRC guidance

- SPFs are those involved in creating the loan and managing it. This requires active decision-making with regard to the acceptance of risk and its ongoing management.
- An intra-group loan may require little ongoing management, in which case SPFs relevant to the initial assumption of risk are more important.
- HMRC guidance notes that:
  - Only certain functions will be identified as SPFs
  - SPFs may performed by one or more persons
  - SPFs will be carried out in different locations and proper consideration is to be given to relevant resources employed in those locations
  - Not all SPFs are of equal value
  - If CFCs do not evaluate the risks of the loan, HMRC assumes activities are performed in the UK
- The following activities in isolation would not be treated as SPFs:
  1. Completing the contract formalities / signing the contract;
  2. Routine monitoring of the loan (we note that "routine" is not defined); and
  3. Administration of the loan.

Initial thoughts

- HMRC not expecting to result in additional UK tax
- Analysis may not be simple
- Significant compliance burden /need to look back in time
- No current expectation for further guidance to be issued
- Clearances?

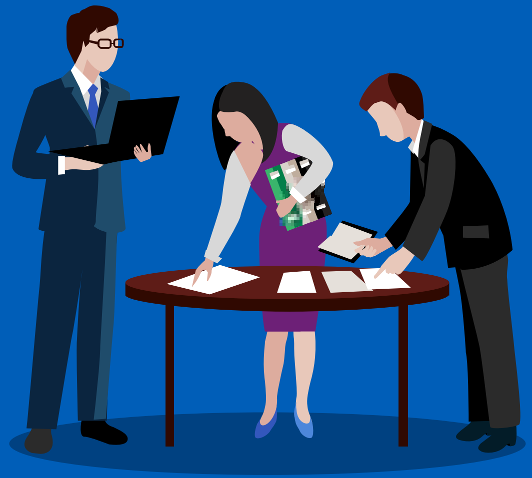
Next steps

— Identification of SPFs and where they were/are performed.

— Modelling of potential exposures post 1 January 2019.

— Analysis of alternative exemptions from the CFC rules.

— Restructuring (where appropriate).



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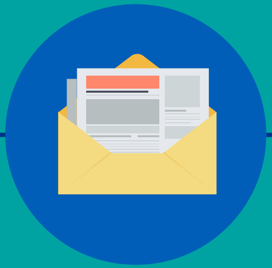
TP considerations when refinancing

TP considerations when refinancing: break fees

Break fees



When?

If financing agreements are terminated prior to maturity date.

What?

Consider if break fees need to be paid.

Why?

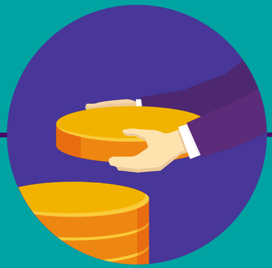
To reflect arm's length conditions.

How?

- Check if there are existing termination / break fee clauses in the agreement.
- If there are existing clauses, check if terms are arm's length.
- If no clauses exist, analyse the TP impact.

TP considerations when refinancing: market vs book value

Transfer of financial assets (e.g. loan instruments)



When?

Restructuring financing agreements (e.g. transfer of loan instruments or change in ownership of Fincos which are party to various loan instruments).

What?

Consider market value instead of book value.

Why?

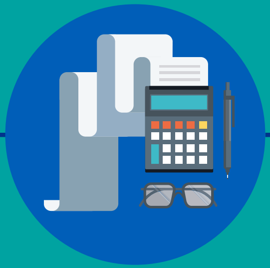
The market value may differ from the book value due to changes in (i) credit profile of loan instruments or (ii) interest rates.

How?

Tax or TP valuation.

TP considerations when refinancing: break fees

Repricing loan agreements



When?

Restructuring loan agreements.

What?

Consider key terms agreed in respect of new loan agreements. Consideration to be given to:

— Quantum of debt;

— Credit worthiness of borrowers; and

— Interest rates.

Why?

To reflect arm's length conditions.

How?

Benchmark against comparable loan agreements in the market.

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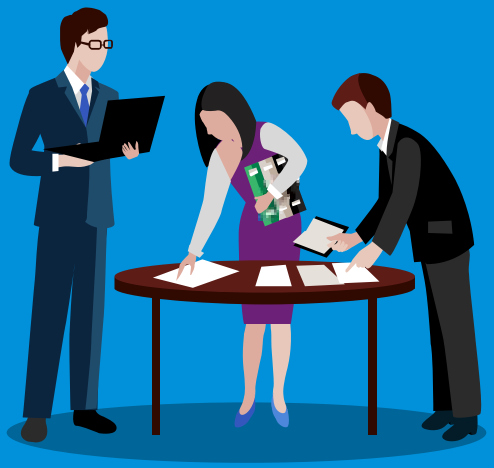
Closing comments



Questions

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