

At A Glance

Transfer Pricing Solutions for Treasury Services

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Overview

Cases in recent years have highlighted the relevance of transfer pricing to corporate treasury functions. In the UK, for instance, the Dixons case (DSG Retail and other vs HMRC) focused on captive reinsurance arrangements and the Special Commissioners found that the taxpayer's filing position was not adequately supported by comparable uncontrolled price benchmarking data. The subject of a case before the Tax Court in Canada, meanwhile, was the Canadian Revenue Authority's denial of US\$125.5m of guarantee fees paid by GE Capital Canada to its US parent. This assessment was overturned by the court, and is now subject to appeal.

Further challenges facing taxpayers and practitioners have been posed by the financial crisis of 2008-09, which undermined old rules of thumb and previously tried-and-tested methods used to determine arm's length pricing for intercompany finance and treasury related transactions.

Given the above, it is increasingly important that taxpayers have robust policies and processes in place to ensure not only that intercompany financial transactions are carried-out at arm's length, but also so that this can be demonstrated to be the case.

NERA's Capabilities

By drawing on expertise in both our Transfer Pricing and Securities and Finance Practices, NERA is uniquely positioned to assist in-house practitioners and tax advisors manage risk and deliver value on issues related to treasury services.

NERA's relevant expertise includes the following:

- pricing financial transactions, including in relation to cash pooling, loans and structured finance, guarantees, leasing, and commodity and FX hedging;
- applying CAPM and other economics-based approaches to thin capitalisation analysis, and assisting clients in obtaining rulings and defending filing positions;
- advising on the design and implementation of transfer pricing models that correspond to different treasury services models (e.g. conduit arrangements, in-house banking, etc.);
- conducting risk assessment exercises and providing recommendations on good practice regarding policy and processes in transfer pricing for treasury services;
- preparing or assisting in the preparation of transfer pricing documentation in line with OECD Guidelines and, where, appropriate, local rules and regulations;
- where not already met by contemporaneous transfer pricing documentation, assisting clients in preparing analyses and/or documentation to satisfy auditors concerning tax provisions;
- providing specialist economics and finance input to support a taxpayers' filing positions where tax authorities have raised queries;
- providing expert testimony in that event that cases proceed to litigation.

Our Experts

The firm's Global Transfer Pricing practice is led by Dr. Emmanuel Llinares, who specializes in inter-company pricing, valuation, and intellectual property analyses. Dr. Llinares has advised multinational companies on defining and implementing their intra-group pricing policies and has assisted them with design, documentation, and tax audit defense. He also assists clients in the context of commercial or intellectual property-related litigations. Dr. Llinares received a PhD in economics from the University of Delaware and a doctorate in economics from the University of Lyon. He publishes frequently on the subjects of transfer pricing and valuation.



Dr. Chudozie Okongwu leads NERA's European Securities and Finance team. He came to NERA from Banque Paribas's Fixed Income Emerging Markets team in London and New York, where his responsibilities included trading local currency instruments and marketing a broad range of products including bonds, loans, OTC options, and credit derivatives. At NERA, he directs advisory and litigation support projects for clients in Europe and North America in the areas of securities economics, finance, and valuation. Dr. Okongwu has testified and consulted on matters involving the valuation of various derivatives, fixed income and equity products, and exotic financial structures, and has provided testimony in mediations and arbitrations. He also has substantial experience on matters involving risk management. Dr. Okongwu has PhD and MA degrees in economics from the University of California, Berkeley and an S.B. degree in economics from the Massachusetts Institute of Technology.

Relevant Experience

Multinational Advertising Agency

The purpose of the project was to review the group's transfer pricing policies, documentation and systems relating to its treasury services function in the EMEA region, and provide recommendations concerning areas for improvement and further work. The project included carrying-out a risk assessment focusing on interest rates applicable to intercompany balances maintained in different currencies in notional cash-pools, FX netting and leasing. Advice was given on the rate setting process from a technical and practical perspective, and on the efficient preparation of documentation to support the group's filing position. The project report was used to address specific points in HMRC's risk assessment process.

Global FMCG Group

Advice was provided to the central and regional treasury functions of this group concerning arm's length parameters for cash pooling arrangements, intercompany funding and commodities hedging. Assistance was additionally provided in pricing specific financial instruments and guarantees, and in drafting OECD and US compliant documentation. In regard to guarantee fees, support was also given in defending the group's position with its auditors.

Global Consumer Product Multinational

The aim of this project was to assist a UK based global multinational group in establishing a centralised treasury company that was to be responsible for funding the group's operations worldwide, managing its surplus funds and cash-pooling, and mitigating group-wide exposures to financial risk. Establishment of the new company allowed the group successfully to rationalise and streamline pre-existing global treasury operations. Assistance was also provided in implementation.

Multinational Industrial Group

This project involved reviewing the group's treasury operations to confirm whether the transfer pricing policies applied by the group comply with the arm's length principle. The treasury functions considered as part of this review included intercompany lending, cash management, and FX and commodities hedging.

Real Estate Thin Capitalisation

This project evaluated the capital structure of a real estate special purpose vehicle in line with thin capitalisation requirements in Spain. To assess whether the tested party's level of gearing was consistent with the arm's length principle, an interquartile range

was first derived for gearing levels reported by companies comparable to the SPV operating in similar circumstances. The results of this analysis were substantiated using the Capital Asset Pricing Model as a second market-based approach. The study formed part of an Advance Pricing Agreement with the Spanish tax administration.

Loan Pricing

Specialists in our Transfer Pricing and Finance & Securities Practices have been involved in numerous studies aimed at determining the arm's length interest rate payable on intercompany loans. The analyses typically have involved a detailed evaluation of the terms of the transaction, the profile of the borrower, and the risk assumed by the lender. Based on this evaluation, shadow credit scores were determined for the borrowers and subsequently used to identify comparable transactions. Adjustments were made in the benchmarking to account for specific features of the loans, including subordination.

Guarantee Fee Tax Audit

In response to a tax audit, our experts conducted a study for a UK based oil and petroleum trading company to price a parental guarantee for lines of credit provided by third party banks. To estimate the arm's length guarantee fee the expected loss approach was used as the primary pricing method. The results were then substantiated by performing an analysis of credit default swap data, taking the credit rating of the guaranteed entity into account.

NERA's Transfer Pricing Practice

NERA Economic Consulting offers a full range of transfer pricing services, independent advice, and valuation by world-class experts and dedicated teams of transfer pricing economists in major cities worldwide. Focus areas include:

- Transfer pricing strategy design
- Transfer pricing system implementation
- APA, controversy and litigation support
- M&A and business restructuring support
- IP and business valuation
- Financial transaction pricing

About NERA

NERA Economic Consulting (www.nera.com) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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