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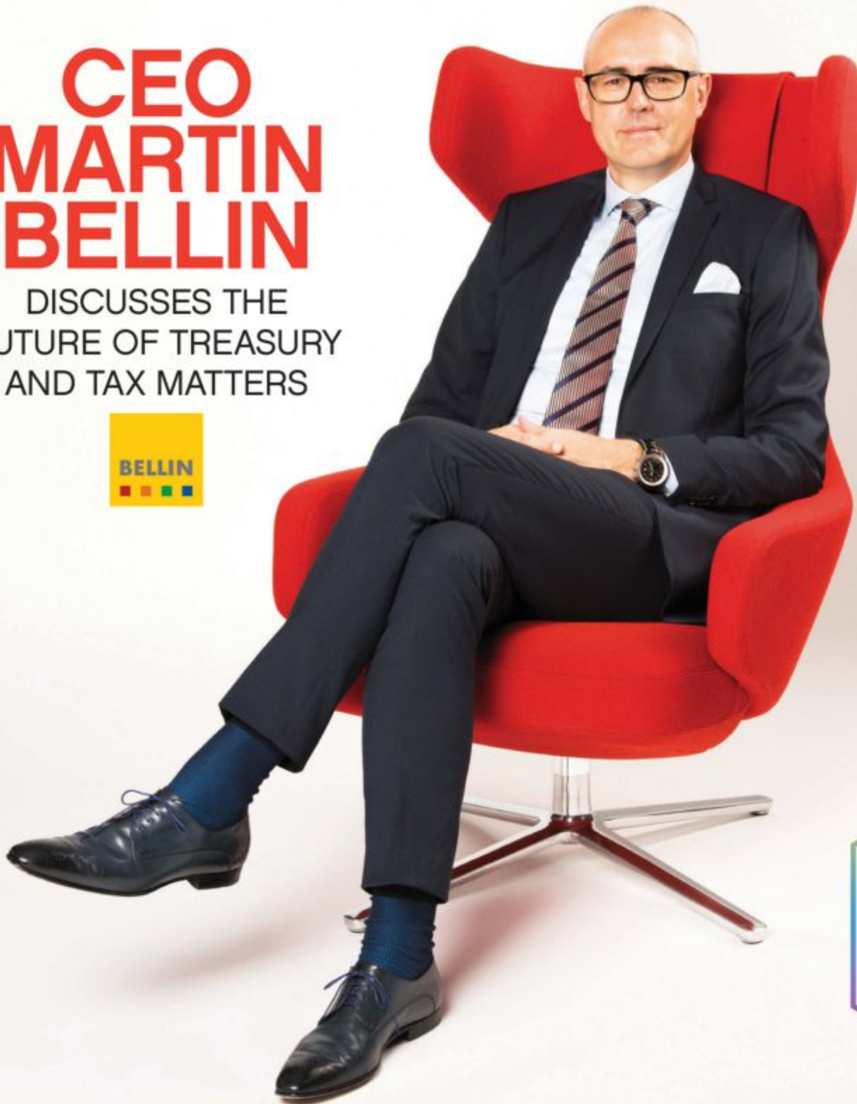
CEO MARTIN BELLIN

DISCUSSES THE FUTURE OF TREASURY AND TAX MATTERS



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REPORTS AND INTERVIEWS FROM THE PEOPLE SHAPING THE BUSINESS LANDSCAPE

The Role of BEPS for Treasury Management

By: Martin Bellin

Tax avoidance techniques of high-profile multinationals, including IKEA, Apple and Starbucks, have recently made public headlines and caused quite a stir. Subsequently, the debate surrounding base erosion and profit shifting (BEPS) made it onto the agenda of the highest levels of government, given that many of these schemes may be "sticky" but are actually legal. BEPS refers to the negative effect of multinational companies' tax avoidance strategies by profiting from non-standardized taxation rules and minimizing their tax burden by way of profit reduction and profit shifting. Public outrage culminated in an Action Plan put forward by the Organization for Economic Cooperation and Development (OECD) addressing international tax rules and their perceived flaws by recommending 15 points of action.

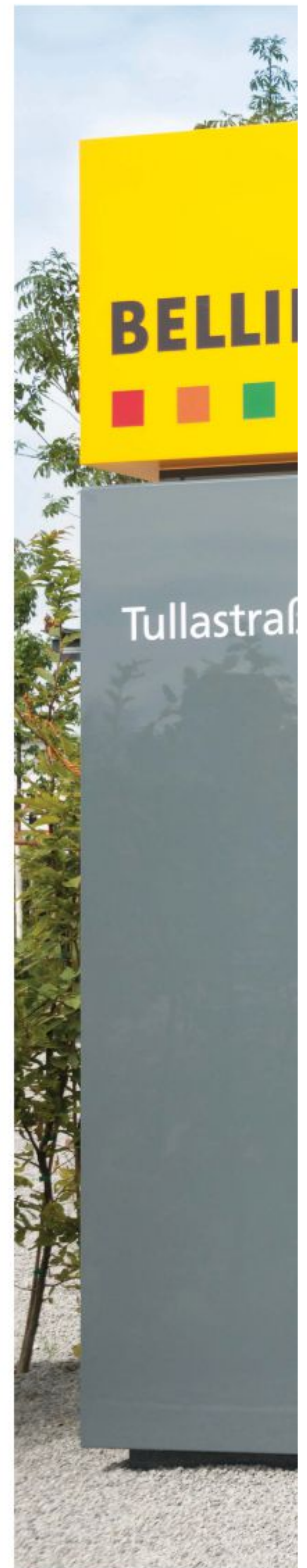
While traditionally taxation issues have not been considered one of the primary focuses of treasury management, all financial aspects which have an impact on business ultimately also concern treasury. This is therefore equally true for taxes and hence also for tax evasion. One major point addressed by the OECD's Action Plan is intercompany financing transactions – something which is at the heart of treasury management. Transfer pricing and its taxation as well as country-by-country reporting in particular play an important role here. A large part of treasury management is dedicated to intercompany trade, including intercompany financing and hedging. Most large, professional treasuries establish in-house banks that provide centralized financing. Instead of dealing with external banks, subsidiaries are now dealing with internal in-house banks to which they can turn for financing.

This leaves the question of fees and interest rates for intercompany trade. For example, the appropriate interest margin in the context of an intercompany loan primarily depends on the creditworthiness of the subsidiary in question – the more creditworthy, the lower the margin and consequently the interest burden for the subsidiary. It follows that businesses need to rate the creditworthiness of all their subsidiaries in order to set appropriate margins. This applies to loans as well as intercompany prices. This in turn has an impact on taxation. Most countries' tax legislation makes provisions for transfer pricing and thin capitalization but they are often not specific to financial transactions. Mostly, intercompany loans are addressed, in particular with regards to interest rates. Typically, this is based on the so-called comparable uncontrolled price (CUP), considering in particular terms and conditions of the loan as well as the creditworthiness of the debtor. Alternatively, the so-called Benefit Method

"The objective of the OECD's Action Plan is to improve tax authority's ability to evaluate transfer pricing risk."

is applied, assessing the interest rate benefit obtained based on guarantees. Ultimately, the margin is not just a matter of interest rates, but must be applied to FX trades, intercompany guarantees, credit facilities and other financial instruments in the same way.

The objective of the OECD's Action Plan is to improve tax authority's ability to evaluate transfer pricing risk. This also includes the assessment of the creditworthiness of a subsidiary based on its membership in a group – assuming the parent company would intervene in case of financial difficulties. Forming part of a group can have a positive impact on the credit rating of an individual company; something it might not achieve on a stand-alone basis. Vice versa, a parent can actually >



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profit from the high creditworthiness of a subsidiary. Often, backing by the parent company is considered a sufficient security. Action point 8 of the OECD's Action Plan provides guidance on transfer pricing aspects of intangibles, while Action 13 refers to transfer pricing documentation and country-by-country reporting. Some of the main transfer pricing issues within this context are closely related to other issues, such as the allocation of risk among group members.

Within this framework, the example of Bremer Vulkan, at the time one of Germany's largest shipbuilders, springs to mind. Its demise back in 1996 was tainted by faltering profits and pending insolvency masked by large infusions of public subsidies. West German management syphoned off EU subsidies provided to the shipyards in the east convincing the banks for a long time that payment problems were only temporary. By the time the books were scrutinized more closely, the debts were too high to salvage the group. In this case, failure to properly check the creditworthiness of all business parts led to the entire business defaulting.

All this illustrates that proactive receivables management actually plays a much more important role than treasurers often acknowledge. BELLIN has responded to this by incorporating a whole module, **TP**CREDIT, as part of our treasury management software tm5. This module exclusively aims at controlling and reducing losses in connection to receivables from third parties which is very often the largest asset in the balance sheet of the different subsidiaries. By tracking all receivables from third parties groupwide, **TP**CREDIT permits analysis of each third party's payment history, giving businesses the ability to tell when third parties may be at risk of default before this risk becomes reality and the finances of the affected subsidiary are in trouble. At a subsidiary level, it can be hard to tell who is at risk, but by sharing this information companywide, such patterns become apparent. This allows companies to dramatically reduce day's sales outstanding and even the loss of receivables from third parties. Visibility is key, and a good TMS can provide exactly this.

"For now, the recommendations put forward by the OECD have yet to be adopted on a global level."

For now, the recommendations put forward by the OECD have yet to be adopted on a global level. What has been achieved is a closer scrutiny of tax avoidance schemes. Overall, tax regulations are still characterized by inconsistency and a lack of guidance with regards to transfer pricing and the management of intercompany financial transactions. There is still no guarantee for the consistent treatment of intercompany transactions. BEPS is meant to change the way in which global businesses operate. Compliance and visibility are major factors here. This remains a global challenge which needs to be addressed – both from a taxation and a treasury management point of view.

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