



# ARE YOUR LOANS AT ARM'S LENGTH?

**Transfer Pricing  
Webinar**

24 February 2022

**Your global tax partner**

# Our Presenters



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# AGENDA



1. Changes to the Mauritius Tax Regime
2. Application of Arm's Length Test
3. TP Guidance for Intra-Group Loans (OECD TPG 2022)
4. Case study: Treasury Company
5. Discussion
6. Q&A

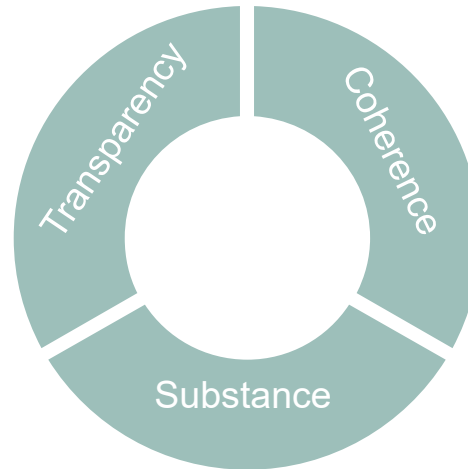
# Changes to the Mauritius Tax Regime

**Feroz Hematally**

# BEPS Action Points



- Action 15 - Develop a multilateral instrument
- Action 11 - Establish methodologies to collect and analyse data on BEPS and the actions to address it
- Action 12 - Require taxpayers to disclose their aggressive tax planning arrangements
- Action 13 - Re examine transfer pricing documentation
- Action 14 - Make dispute resolution mechanisms more effective



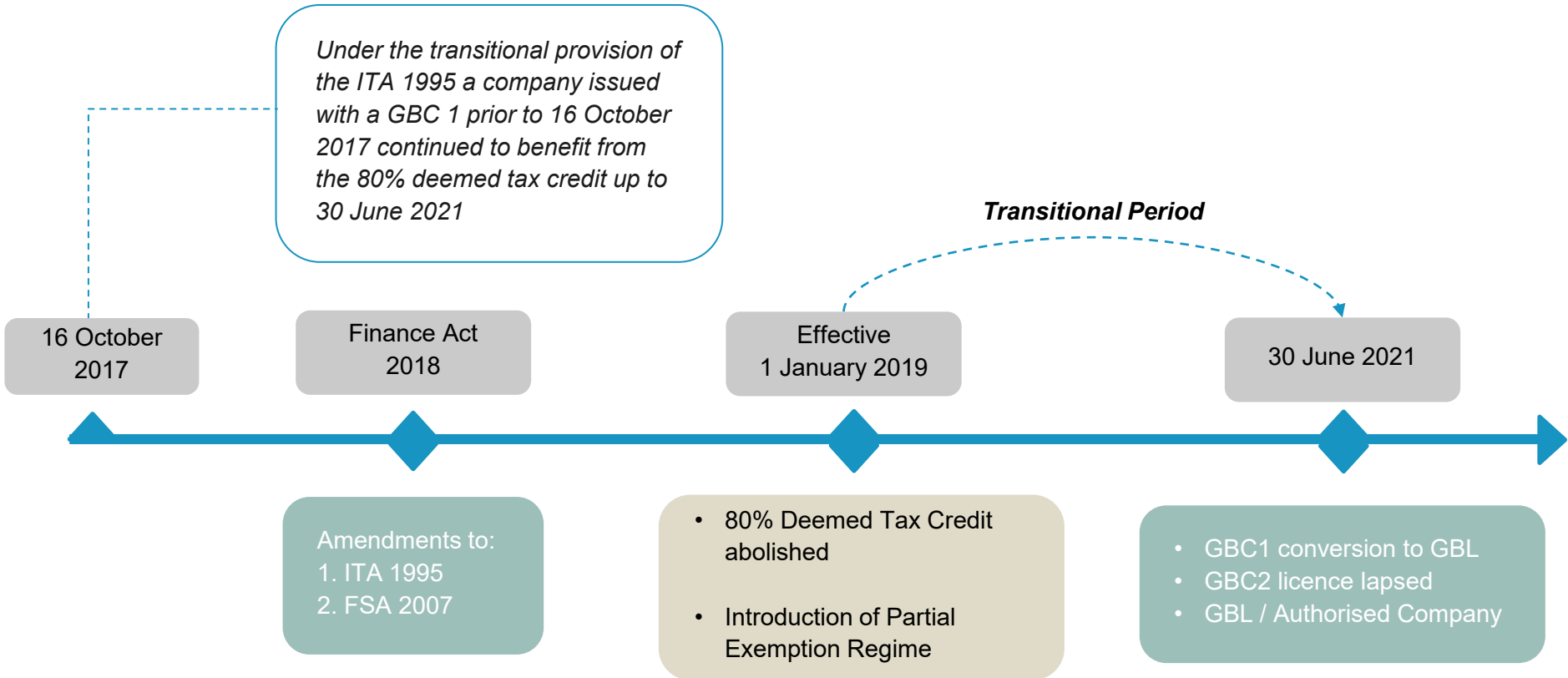
- Action 1 - Address the tax challenges of the digital economy
- Action 2 - Neutralize the effects of hybrid mismatch arrangements
- Action 3 - Strengthening CFC rules
- Action 4 - Limit base erosion via interest deductions and other financial payments
- Action 5 - Counter harmful tax practices more effectively, taking into account transparency and substance

- Action 6 - Prevent treaty abuse
- Action 7 - Prevent the artificial avoidance of PE status
- Action 8 - Transfer Pricing : Intangibles
- Action 9 - Transfer Pricing : Risk and capital
- Action 10 - Transfer Pricing : Other high risk transactions

**Key:**

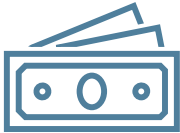
- Minimum Standards
- Reinforced international standards
- Common approaches & best practices
- Analytical reports & measuring BEPS

# Timeline



# Category 1 Global Business Licence

## Old regime



GBC1 was taxed at 15%. However, it was eligible to 80% deemed foreign tax credit or actual tax suffered to offset against Mauritius tax payable, whichever was higher

# 80%

Deemed FTC of 80% was available on all income types to all GBC1 companies irrespective of license type



Actual foreign tax would include any withholding tax or underlying tax suffered on the foreign source income

# Global Business Licence

## New regime



Phasing out of Deemed FTC effective as from 1 Jan 2019

Grandfathered companies up to 30 June 2021

# 80%

Introduction of 80% partial exemption regime on specified income



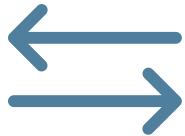
No actual foreign tax credit is allowed on foreign source income if the GBL company has claimed the 80% exemption



# Application of Arm's Length Test

**Feroz Hematally**

# Transfer Pricing in Mauritius



TP in Mauritius

## Mauritius response to OECD's Action Plan

- Introduction of Country-by-Country Reporting for the accounting years beginning on or after 1 July 2018.
- Announced in 2018 National Budget to introduce TP Legislation.

## What's happening in Mauritius?

- Currently the tax authorities are raising assessment on intragroup transactions under:
  - Section 75- Application of arm's length test
  - Section 90 - Transactions designed to avoid liability to income tax

## Consequences of the assessments:

- Imputing interest on interest free/ low interest loan receivable;
- Restricting deduction of interest expense

# Application of arm's length test S75 ITA



## Pre FA 21



- Applicable for any business or income earning activity in Mauritius

## Post FA 21



- Applicable for any business or income earning activity in or from Mauritius

# Bay Lines v Director General, Mauritius Revenue Authority ARC/IT/377-16



## Issue

Application of S75 to **Global Business Licence** companies

## Facts

The Applicant held a Category 1 Global Business Licence and **the MRA raised an assessment on the arm's length principle**

## Ruling

It was decided by the Committee that **Section 75 did not apply** given that it applies to “business or other income earning activity **carried on in Mauritius.**”

The company did not carry on any business or other income earning activity **in Mauritius.**

## Timeline of event

**ARC Case: March 2021**

**Finance Act update: August 2021**

**TP Guidance  
for Intra-Group  
Loans  
(OECD TPG 2022)**

**Gaspar Lopes**

# TP Guidance for Intra-Group Loans (OECD TPG 2022)



## Accurate delineation of the controlled transaction under Chapter I

- Alignment of the actual conduct of the parties (FAR analysis) and the contractual terms
- Characteristics of the financial instruments
- Economic circumstances (of the parties involved in the transaction and the market)
- Business strategies (purpose of the loan, MNE group's global financing strategy/policy)
- Options realistically available

## Multi-factor analysis of the characteristics of the instrument and the issuer

- Quantitative methods (debt capacity analyses)

## Consider domestic legislation

- Thin capitalization rules
- Limitation on interest deductibility measures
- Safe harbours

# A two-sided perspective



## Typical key functions performed by a lender



- decide whether and under which terms (including amount) to advance funds
- evaluate of the risks inherent under the loan
- asses the capability of the borrower to attract funds in light of the borrower's availability of own capital (financial capacity)
- supporting and documenting the loan
- ongoing monitoring and periodic review of the loan
- evaluate (investment) options realistically available

## Typical key functions performed by a borrower



- ensuring the availability of funds to repay the principal and the interest on the loan in due time
- providing collateral
- monitoring and fulfilling any other obligations resulting from the loan
- evaluate (funding) options realistically available

# Functional Analysis



For intra-group loans it is important to ensure the functional analysis examines/includes

- Intra-group loan agreements
- Business plans for the borrower
- Forecast financial statements
- Financial modelling of loan servicing
- External loan agreements (of any group companies)
- Reports to external lenders
- Board papers
- Prospectuses issued by the group
- Interviews with the group treasurer, CFO, operational manager

May need to use specialist for the functional analysis



# Approaches to price intercompany loans



Different approaches based on the application of the CUP method

- Internal CUP
- External CUP
- Returns of realistic alternative transactions (economically cognate instruments; such as bonds, commercial papers, deposits, etc.)
- Cost of funds approach (lender's perspective)
- Economic modelling (build-up approach)
- Bank opinions – 'generally not relevant for purposes of pricing intercompany loans

# Intra-Group Loans Comparability



Group loans from external parties (must be comparable)

Commercial databases

Ask a bank to indicate the interest rate it would have charged

Ask a bank for a formal loan review and the issue of a loan offer

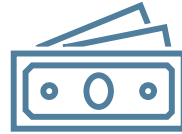
Get a credit rating for the borrower (expensive)

# Determining Interest Rates



%

Interest rate is determined by:  
amount to reflect use of money  
amount to reflect risk



If there is no risk of default there is still a charge for the use of the money – often referred to as the base rate



Lenders want to be competitive; they also want to make a profit

## Key factors

- Credit worthiness of the borrower
- Macro economic conditions

# Factors affecting Credit Worthiness



## Main Factors

- Collateral (Assets pledged for the loan)/Security given
- Asset backing
- Level of other loans
- The ranking of the debt
- Gearing/leverage
- Interest cover
- Cash flow
- Covenants
- Guarantees
- Business risk
- Track record
- Purpose of the debt
- Industry prospects

# Evaluation of the risks – Credit rating

## Group credit rating

View of the consolidated creditworthiness of the group

## MNE credit rating

stand-alone credit capacity of the subsidiary plus the effect of implicit support

## Specific issuance rating

considers additional factors such as ranking, security, or the existence of guarantees

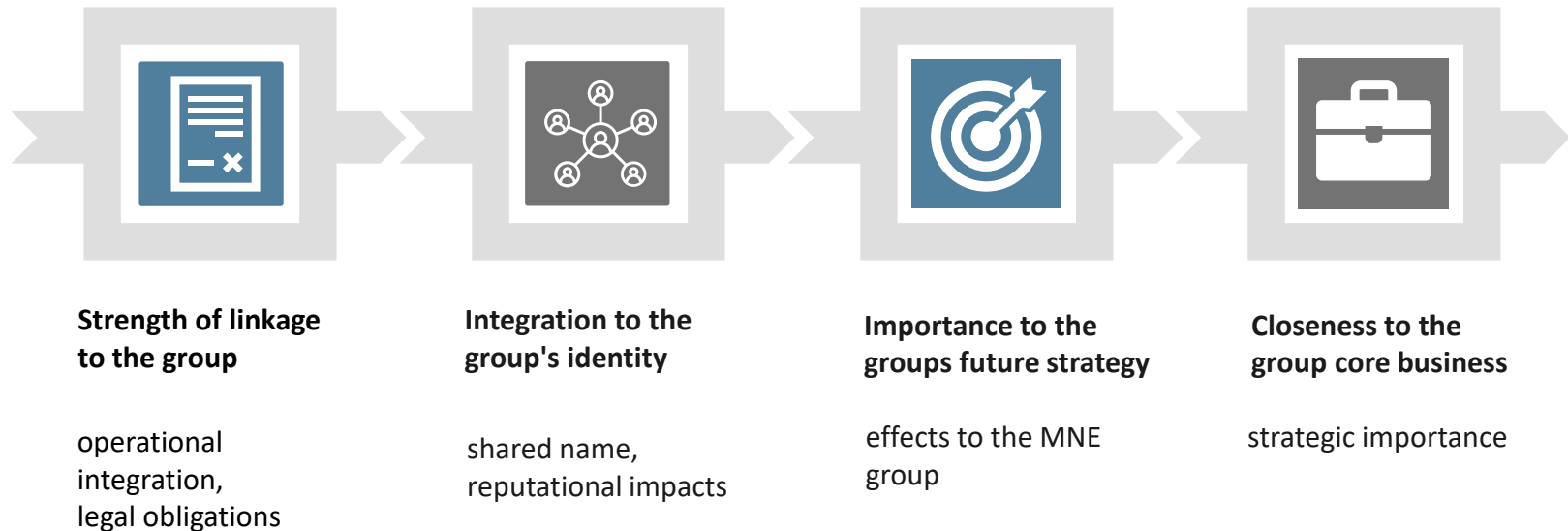
## Credit rating analysis

- Understanding of the business
- Purpose of the loan
- Borrower's cash flow forecasts
- Strength of borrower's balance sheet

## Points of attention:

- No specific guidance on the calculation of appropriate adjustments (e.g. ranking, security, implicit support etc.)
- The Guidance emphasizes the use of specific issuance rates where possible

# Implicit support and the relative status of an entity



# Other important factors to consider



## Other Factors

- Comparability analysis. Consider the proximity in time of the analyzed transaction and the comparables
- How market circumstances affect refinancing options and when should those be revisited (ORAs).
- Disclosure of information, to be included in the master file re MNE group's global financing strategy/policy, CbCR re people and assets per jurisdiction, TP hallmarks for DAC6, etc.
- Industry-specific factors

# Debt Capacity Analysis: Amount Borrowed



Analysis

- Can be tested by ratios such as Debt to EBITDA and Debt to Equity
- The company's ratios would then be compared to those of other companies operating in the same sector and with the same economic circumstances



**Case study:  
Treasury  
Company**

**Feroz Hematally**

# Example: lender and borrower perspectives

A 10 year loan is provided to a member of the MNE group, which is known to be unable to serve the loan

- An unrelated party would not be willing to provide such loan
- The accurately delineated amount of the loan, for transfer pricing purposes, is a function of:
  - the maximum amount that an unrelated lender would have been willing to advance
  - the maximum amount that an unrelated borrower would have been willing to borrow
- Possibility of not lending or borrowing any amount, or doing so under certain terms and conditions
- The remainder funds advanced would not be delineated as a loan



# Example: Intercompany loans

A 10 year loan is provided to a member of the MNE group, which will use the funding for short-term working capital purposes

- The Group's policy and practices demonstrate that the MNE group uses a one-year revolving loan to manage short-term working capital (business strategies)
- An unrelated borrower would not enter into a 10-year loan agreement to manage its short-term working capital needs (economic circumstances)
- The transaction would be accurately delineated as a one-year revolving loan (options realistically available)



# Case study: Treasury Company

Christos Theophilou

# Functional profiles of a treasury company – example per transaction



|                          | Agent | Risk-bearing | Strategic Treasury Company |
|--------------------------|-------|--------------|----------------------------|
| Intra-Group Loans        |       | X            |                            |
| Cash Pooling             |       |              | X                          |
| Hedging                  |       | X            |                            |
| Financial Guarantees     | X     |              |                            |
| Other financial services | X     |              |                            |

# Case study: Treasury Company Location

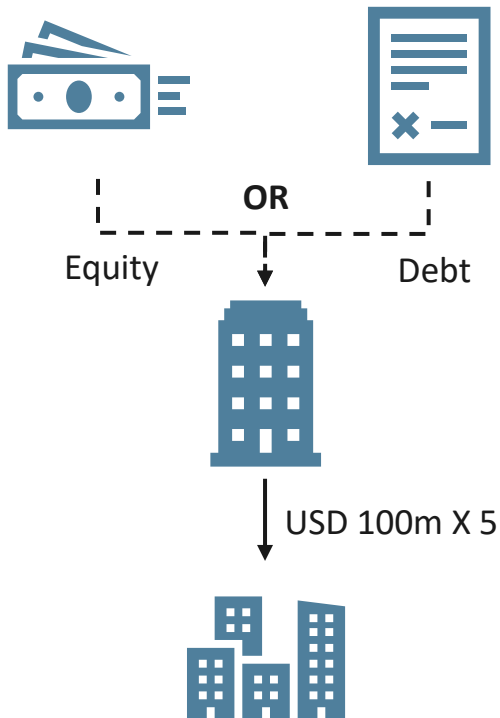


## Choice of location considerations

- Reliable legal system
- Privileged access to financial institutions and capital markets
- Country credit rating
- No interest withholding tax
- Interest deductions not restricted
- Broad tax treaty network
- Access to finance professionals
- Corporation tax rate
- Availability of APAs, relationship with the authorities
- Cost level
- Need to manage tax and TP compliance obligations and requirements
- Indirect taxes (e.g. VAT treatment), transactional taxes, wage taxes
- Uncertainty factors, (e.g. Covid19 pandemic)

# Case Study

## Group Financing company



The Group financing Company needs to provide loan of USD 100m to 5 of its subsidiaries in different part of the world.

Therefore, it needs to raise capital of USD 500m  
It can do so by way of:

- Equity - Issuing new shares;
- Debt- Issuing Bonds to third party persons;
- Debt-Equity: Issuing convertible notes

Functional analysis?  
TP method and approach?  
Remuneration?



# Discussion



# Discussion points



- In which area of financial transactions can we expect audits from tax authorities following the guidance as presented in Ch. X?
- Do we need to adjust our way of testing / documenting financial transactions? If so, how?
- What are the main (commercial) opportunities taking into account the guidance of the OECD?
- How does the Covid-19 crisis affect financial transactions TP and how can we best help clients on this topic?



**Q&A**

# Key Takeaways



- Chapter X provides a comprehensive overview of key intra-group Financial Transaction topics
- Broad implications on financial transactions which impact all multinationals
- Limited guidance on practical implementation – room for discussion?
- Some of the guidance raises practical issues
- Tax authorities worldwide are expected to use the new guidance to actively audit financial transactions operated by MNEs
- Going forward, more extensive transfer pricing analyses and (legal) documentation may be required with respect to intercompany financial transactions

# Thank you for your attention



For further information, please contact:

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