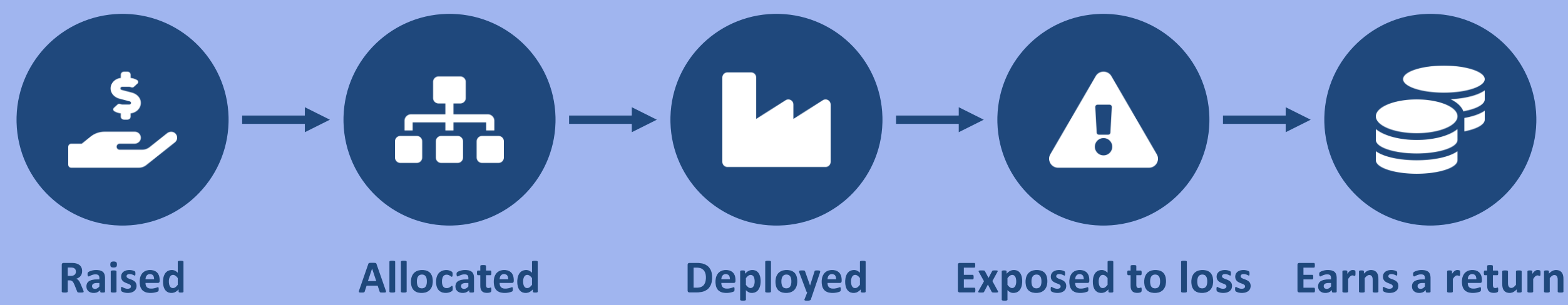


The Role of Financial Capital in Transfer Pricing under the Arm's Length Principle

THE PROBLEM: ONE CAPITAL, FRAGMENTED TREATMENT

Economic reality: in an MNE, capital is one continuous position



The same capital underlies every stage — an MNE does not hold one capital to bear risk and another to earn a return.

OECD Transfer Pricing Guidelines: capital appears in separate places, for separate purposes

Ch. I

Financial capacity to assume risk

Ch. II–III

Comparability factor and profit level indicators

Ch. X

Object of financial transactions to characterise and price

The gap: the OECD Transfer Pricing Guidelines never articulate what capital is for transfer pricing purposes, which of its characteristics matter, or how its different roles relate to one another.

? MAIN RESEARCH QUESTION

What role does financial capital play in transfer pricing analysis under the arm's length principle, and to what extent does the current OECD framework reflect the economic realities of MNEs?

SCOPE

- **Financial capital:** resources contributed by associated enterprises through debt or equity, including the resulting capital structure.
- **Why this focus:** providing capital may itself constitute a controlled transaction, while its availability and characteristics also affect the analysis of other controlled transactions.
- **Excluded:** physical assets, IP and know-how are outside the scope. Other sources of financial capacity are considered only where relevant to debt and equity funding.

STRUCTURE: FINANCIAL CAPITAL, FROM CONDITION TO CONSEQUENCE



PART I · FOUNDATION

Financial Capital in Corporate and Transfer Pricing Context

Which characteristics and functions of financial capital are relevant to transfer pricing analysis?

- Defining financial capital for transfer pricing in relation to its accounting, finance and regulatory meanings
- Debt, equity and capital structure: amount, duration, repayment, rights to returns and exposure to losses
- Distinguishing capital's economic functions from the activities of those who provide or manage it



PART II · CONDITION

Financial Capital and Risk Allocation

Under what conditions, and to what extent, does capital give an enterprise the financial capacity to assume risk?

- Form: when debt suffices and when an equity cushion is needed
- Terms: amount, maturity, subordination and capacity to absorb losses
- Availability: future funding and implicit versus explicit parental support



PART III · OBJECT

Capital as the Object of Controlled Transactions

How far may the arm's length principle shape the form, amount and conditions of intra-group funding, and how is it priced?

- Form: debt vs. equity and the interaction with domestic rules
- Amount: what could vs. would be borrowed
- Conditions: price adjustments versus structural adjustments
- Pricing: implicit support and the different treatment of debt and equity



PART IV · CONSEQUENCE

Return to Capital

When does providing capital justify a return, at what level, and how should it be measured?

- Entitlement: provision of funds, control of financial risk and financial capacity
- Measurement: determining risk-free and risk-adjusted returns
- Residual profits: whether and when capital warrants a share
- Expected and actual returns: allocating unexpected profits and losses



Expected contribution: An integrated framework tracing financial capital from financial capacity through financing transactions to returns, identifying where the OECD TPG's differentiated treatment is justified by capital's distinct functions and where greater coherence is needed.