

Tax considerations in light of Transfer Pricing when setting up Zero Balance Cash Pool arrangements

January 2021, Paul Buck

International companies are taking benefit of group synergy by entering into Cash Pool arrangements to support a group strategy. This strategy usually includes improved cash management and interest yield on cash.

As such arrangements are rarely (or not at all) found between independent parties, Cash Pool arrangements may attract attention of local Tax Authorities and will therefore be subject to scrutinizing. When local Tax Authorities challenge Cash Pool arrangements, the result may be:

- Arrangements may not be considered as arm's length transactions if there is a better option realistically available for the cash pool participants
- Potential double taxation or penalties
- Non-deductibility of interest expense

Some countries (such as the United Kingdom, Germany and Australia) have transfer pricing guidance or tax rules on the treatment of cash pooling arrangements. Other countries may be lacking such guidance or tax rules. Also, a Cash Pooling arrangement could be treated as something other than a short-term cash pool balance if, e.g. when balances are outstanding for a long time or if the funds are used for a different purpose than that intended. Therefore, there is a risk of re-characterization of the cash pool transactions by local Tax Authorities. They can consider cash pooling arrangements as a loan or guarantee or a mixed contract with a different result.

Below is a summary of legal cases in Poland, Switzerland, Denmark and Norway, illustrating how various Tax Authorities may scrutinize and challenge Zero Balance cash pooling arrangements, having consequences from tax and transfer pricing perspective for companies that enter into Cash Pool arrangements.

These cases together with the *"OECD Transfer Pricing Guidance on Financial Transactions – Inclusive Framework on BEPS"* may support companies in establishing a proper framework from transfer pricing perspective to manage interest remunerations in Cash Pool arrangements. Having a well-documented and professional rational embedded in Cash Management agreements between individual group members and the cash pool leader (usually central treasury) may abate the drive from Tax Authorities to challenge company's Cash Pool arrangement; at least it will limit possible challenges and/or discussions.

Cases are presented as Case date and Reference & Summarized court decision.

Denmark Revenue Authorities

- Case Administrative Tax Court No. SKM2014.53.LSR from 21 October 2013 (Revenue Authorities vs Bombardier)
- Requirement for a Cash Pool or Cash Management Agreements between participating group members and the cash pool leader (usually central treasury)
- Clearly stipulating the Arm's Length interest remuneration, explaining how the transfer pricing rates are determined or calculated.

- Cash pool leaders (usually central treasury) who act like an In-House Bank are in fact no real commercial banks with commercial risks; hence, interest rates of independent banks are not suitable to serve as appropriate comparables for determining arm's length interest rates for cash pools

Norway Revenue Authorities

- Case Supreme Court HR-2016-988-A, No. 2015/1044 from 5 October 2016 (*Revenue Authorities vs ConocoPhillips*)
- Arm's Length interest to be required to differentiate between debit & credit interest on sweeps and between debit & credit interest on Intercompany loans (credit interest related to cash deposits from the local entity with the cash pool leader - usually central treasury)
- Requirement to differentiate interest spread based on individual legal entity balance sheet risk and (external) bargaining power
- Arm's Length interest spreads should apply a documented ratio including a logical rational between various spreads.

Swiss Revenue Authorities

- Case Administrative Court No. SB.2017.00100 from 12 September 2018 (*Revenue Authorities vs A GmbH*)
- Case Administrative Court No. SB.2016.00008 from 7 December 2016 (*Revenue Authorities vs A GmbH*)
- Cash Pool agreements required to apply a split between remuneration for short term lending (e.g. daily sweeps) and long term lending (e.g. dedicated Intercompany lending to serve a purpose)

Poland Revenue Authorities

- Case Tribunal No. 55/2012-T from 13 November 2019 (*Revenue Authorities vs M. Sp. Z.o.o.*)
- Cash Pool arrangements are to be considered as Intercompany lending
- Requirement for establishing Cash Pool or Cash Management Agreements between participating group members and the cash pool leader (usually central treasury), characterizing cash pool transactions as intercompany loans

With growing demand from governments to limit tax evasion or tax avoidance structures, Revenue Authorities across the globe are more and more discussing and challenge transfer pricing elements of Cash Pooling arrangements (both, from the perspective of the cash pool leader as well as the participants).

Based on the sample cases presented above, together with the "OECD Transfer Pricing Guidance on Financial Transactions – Inclusive Framework on BEPS" I strongly advise companies who have entered into Cash Pooling arrangements, or are about to enter such arrangements, to ensure proper Cash Pool or Cash Management agreements are set up between the participating group members and the cash pool leader (usually central treasury).

Such agreements will require the following elements to be included:

- A Cash Pool or Cash Management agreement is required to be in place with every individual participating group member
- A difference is required to be made between interest associated with (daily) debit and credit sweeps (as this is considered current account cash)

- A difference is required to be made between interest associated with dedicated intercompany loans and cash deposits (a cash deposit from a group member is a reversed intercompany loan to the cash pool leader)
- Current account interest spreads should differ from spreads on -long term- lending/depositing
- Interest spread setting is always taken from the point of view from the cash pool leader (usually central treasury) who acts like an In-House Bank
- Interest spreads taken from an external commercial bank are not suitable to serve as interest spreads for Cash Pooling arrangements
- Though cash pool transactions are to be characterizing as intercompany loans, the ration between current account spreads and -long term- lending spreads that banks apply is still to be observed.
- Individual participating group members must be able to assess Cash Pool arrangements as competitive with independent banks and as such must consider participating in Cash Pool arrangements as beneficial.