CASH POOLING

A TREASURER'S GUIDE

INSIDE

Treasury Alliance Group LLC

www.treasuryalliance.com
+1 630-717-9732
contact@treasuryalliance.com

INTRODUCTION

Liquidity management is an important treasury objective that is challenging because of the need to juggle excess and deficit cash positions across multiple entities, regulatory environments and currencies. For medium to long term cash mismatches a combination of adjusting capital structures via intercompany and third party lending is the best approach. For the short-term—cash pooling—the offset of deficit positions for some entities with the surplus positions of others is the tool of choice. The benefit is elegant in its simplicity: the elimination of the bid/offer spread on these funds along with improved visibility and control of cash.

There are various approaches to pooling so understanding the definitions, options, nuances and tax implications is essential. If done correctly and with support from tax counsel, implementation of a pooling structure can yield significant ongoing benefits for the company. This paper explains cash pooling and identifies the issues for treasury, tax, accounting and business operations.

If done correctly and with support from tax counsel, implementation of a pooling structure can yield significant ongoing benefits for the company.

The Basics

There are two ways of pooling cash—physical and notional.

In physical pooling funds in separate sub accounts are automatically transferred to/from a header or concentration account in order to eliminate idle cash and fund cash outflows. The participating entities are either in surplus or deficit from a transactional perspective, but the bank accounts themselves are zero-balanced. Physical pooling can be used across multiple legal entities, located in the same or different countries—but in the same currency. The funds movement between the participating entities is accounted for via intercompany loans.

Notional pooling achieves the same result, but it is accomplished by making balancing entries on a set of virtual accounts with no changes to the bank accounts held by company entities. The bank managing the notional pool provides an interest statement that reflects the net offset that and is similar to what would have been achieved with physical pooling. As there is no physical movement of money, intercompany loans are not required to account for the offset. This benefit is somewhat negated by strict regulatory requirements that can include the need for cross-guarantees of obligations by participating entities. Notional pooling can be applied on a cross currency basis, but this may further add to the complexity and will be discussed further in this paper.

The following chart provides a high-level summary of the differences between physical and notional pooling:

NOTIONAL POOLING		PHYSICAL POOLING
Interest is earned/paid as bank interest	COMPENSATION	Must use arm's length rate, track loans and allocate interest
Can provide tax efficiency	TAX	Withholding taxes can apply to inter-company loans
Highly complex due to involvement of banks and multiple jurisdictions	COMPLEXITY	Greater transparency generates less regulatory concern
Can be implemented across multiple currencies	APPLICABILITY	Must be done on a currency by currency basis
Restricted in many countries	AVAILABILITY	Widely available and most common form of pooling

POOLING MECHANICS

Notional Pooling

Notional pooling is best explained using the example of a hypothetical company that has three subsidiaries—A, B and C operating in the UK with GBP as the functional currency. The credit interest rate offered by the London branch of the bank is 2.0% and the debit rate of interest is 4.0%.

Subsidiaries	Results
Subsidiary A XYZ Bank Branch 1 (75) at 4%	Traded Separately A pays 3 B earns 4 C earns 2 Company earns 3.0
Subsidiary B XYZ Bank Branch 2 200 at 2%	
Subsidiary C XYZ Bank Branch 3 100 at 2%	Pooled = 225 A pays 1.5 B earns 4 C earns 2 Company earns 4.5

A, B and C enter into a pooling agreement with the bank and credit and debit interest rates are specified. Day-to-day banking business is conducted as usual for the separate legal entities. Daily transactions can be viewed on the bank's web platform and normal reconciliation takes place. The benefit of notional pooling, as this example shows, is that while the company earned 3 on its total position without pooling, after pooling 4.5 was earned through the elimination of the bid/offer spread, a benefit of 1.5 GBP. This benefit is sometimes shared with the participants by the parent company as an incentive to enter into the agreement—but it is not mandatory from a tax perspective.

Because of the simplicity and ease of operation, notional pooling is often the technique of choice for in-country, single currency pools. However, it may not be a wise selection in all countries as it may be subject to scrutiny by local tax authorities—the US and Germany, for example. A basic reason for this is the arrangement may be interpreted as co-mingling of funds. Notional pooling is common as an in-country arrangement in the UK, Netherlands and Belgium, which have minimal, or no, withholding tax on interest earned in a pooling arrangement. There may also be country-specific interpretations that require a holding company to function as the pool manager, which currently applies in the UK and France.

Notional pooling, with the virtual set of accounts the bank maintains to achieve the offset makes bank accounting for the pooling arrangement on its balance sheet an important matter for regulatory authorities in the country where the pool operates. In some countries additional documentation, such as cross guarantees among the pool participants, may be required because deficits from the pooling participants appear as assets on the bank's balance sheet. Because there is no interest earned on these assets they appear to be non-performing loans. To justify its accounting treatment the bank obtains guarantees that enable the right of offset and the ability to use surplus funds to cover deficit positions. The requirement for cross guarantees does not apply in the Netherlands, which serves to explain the popularity of the Netherlands as a location for notional pooling.

Notional pooling, with the virtual set of accounts the bank maintains to achieve the offset makes bank accounting for the pooling arrangement on its balance sheet an important matter for regulatory authorities in the country where the pool operates.

Notional pooling becomes more complicated when it expands from a single country to a multi-country arrangement—due to both the cross currency and cross border nature of the pool. When dealing with more than one currency, even within the same country, it is necessary to bring the currencies to a common base currency, often the Euro or US dollar, before the pooling and interest offset can take place. One technique for doing this is through a short-dated swap. Alternatively, a notional conversion to a base currency can be made with the risk covered through the adjustment of the interest rates paid or charged in each currency. Either approach makes the process more problematic and less cost effective as the bank's desire to be compensated for its risk takes place at the expense of the corporate client pooling its funds.

The advent of the Euro did not fully mitigate the difficulties of cross-border notional pooling. There is the need to accommodate multiple regulatory regimes, demand deposit accounting platforms, dealing rooms and cutoff times. The traditional clearing systems, such as TARGET II, require a physical movement of cash to concentrate the Euro position in one location. Even when a pan-European bank substitutes its network for the clearing systems managing the book involves intervention and work.

Physical Pooling

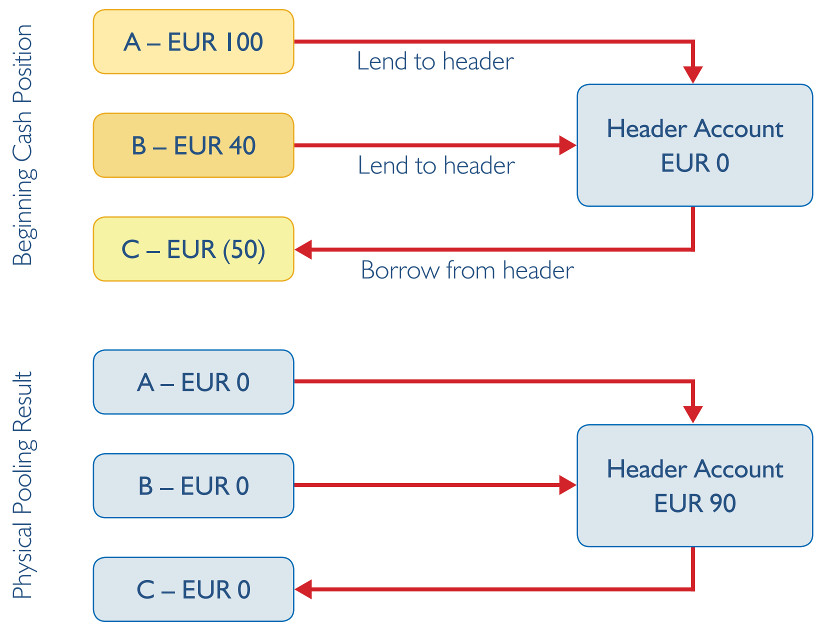
Physical pooling is often referred to as zero-balancing. It can be achieved in a single country or across multiple countries where the pooled accounts are in the same currency. This type of pooling has a long history in the United States where until recently Regulation Q prohibited the payment of interest on demand deposits and interstate banking was not permitted.

Participants in the pool maintain their own bank accounts which are sub-accounts linked to a main or header account. Participants' day-to-day banking business is conducted as usual. Daily activity can be viewed on the bank's web platform and various account services for collections and disbursements can be set up separately in the sub-accounts. The header account is generally a different legal entity from the operating participants and could be the parent company, depending on the country of domicile. The pool header can also be held by a regional subsidiary, a finance company or any other type of special purpose vehicle (SPV), shared service center (SSC) or treasury center. The accounts are maintained in any country where pooling is permitted and are best located where there are efficient payment and bank systems that enable electronic movement of money between accounts. This is an area where large network banks can be particularly competitive because moving money within a bank network through a book transfer is immediate and relatively less expensive.

> Physical pooling is often referred to as zero-balancing. It can be achieved in a single country or across multiple countries where the pooled accounts are in the same currency.

The participants conduct their daily commercial activity, paying and receiving funds, ideally using bank accounts that are part of the pool to minimize money transfer costs. At the close of each business day all positive balances in the sub-accounts are transferred to the header account and any sub-account deficit positions are covered by funding from the header. The overall net position is either invested or, if in deficit, funded through a centralized credit facility. Cash flows between the header and the participant accounts are generally treated as intercompany loans unless all movements take place within the same legal entity.

Consider the example of a company with multiple operations in the Eurozone. Participating entities would open sub-accounts of the header account at the pooling bank. This is illustrated in the diagram below where account positions before and after pooling are shown.



In this situation there are three intercompany loans. A and B are in surplus and lend to the header. C is in deficit and borrows from the header.

Whether the physical pooling takes place within a single country or across border the issues of concern are cutoff times for transactions, actual cost of the transactions and the ability to track the intercompany loans associated with physical pooling. When pooling takes place within the same banking network, the transfers are normally book transfers and transaction fees are typically lower than that levied on a transfer through a clearing system such as Fedwire or EAF. Banks may waive the book transfer charges and assess fees based on a monthly pooling charge based on the number of accounts included in the pooling arrangement or a fixed sweeping tariff.

Because there is a physical movement of funds this type of pooling is not possible on a cross border basis if FX regulations prohibit the unrestricted cross-border movement of funds, as is the case in Brazil, China and India. Where there are significant tax issues relating to intercompany loans such as in Mexico, cross border physical pooling is permitted but is not practical.

Both pooling techniques require that a single bank be used for each pooling structure. However, as notional pooling is virtual, although the structural and interest offset arrangements are with one bank, some providers will use their correspondent bank nostro accounts as conduits in countries where they do not have a physical presence.

Because there is a physical movement of funds this type of pooling is not possible on a cross border basis if FX regulations prohibit the unrestricted cross-border movement of funds, as is the case in Brazil, China and India.

Hybrid Arrangements

Often, a company may have accounts in an excess cash position across various currencies and countries with a single bank. An approach to handling these balances can be through "Interest Optimization". This is more of a negotiated arrangement with the bank than a specific service and works in the following manner:

- Balances at the end of each day in the accounts across countries are collected and notionally converted into a base currency.
- An interest benefit is paid on consolidated balances—this approach assumes all are in a positive position.
- There is no physical movement of funds or FX conversion.

An additional benefit is that trapped cash held in many regulated countries can be included. This approach is like an International Multi Currency Investment Account. Not all banks will offer this service and the interest yield is likely to be very low, as the rate will be based on Fed Funds or LIBOR. Also, the yields may not be competitive with some local interest earning opportunities—such as seven day "cluster deposits" in India or investments over thirty days in Brazil. Although the currency risk still exists with these local investments, that risk is not mitigated by the interest offset arrangement in any case.

Another hybrid approach that can be used as an enhancement to physical pooling is referred to as a notional collar. The best example of this is a company that has established a number of physical currency pools in a single location, such as EUR, USD and GBP in London. The company may choose to fund or invest each pool independently or it may have the bank operating the pools notionally pool the header accounts. Cross guarantees are not required because the header accounts are likely to be owned by the same legal entity. Proactive treasuries may prefer to manage the excess cash positions themselves. When this is the case, decisions can be made whether to invest by currency or enter into short dated swaps in order to achieve the notional pool interest effect. The decision will be driven by liquidity forecasts and governed by corporate risk management and investment policies.

CHOOSING AN APPROACH

The ability of subsidiaries to participate in either a physical or notional pooling arrangement, whether in country or cross border will be dependent on the country-specific regulatory environment where the entity is domiciled. The following chart depicts some high level guidelines:

SITUATION	IN COUNTRY POOLING	CROSS BORDER POOLING
Non-convertible currency	Maybe, varies by country	No
Offshore accounts permitted	Maybe, varies by country	Yes
Restrictions or withholding tax on intercompany lending	Problematic	Problematic
Debit tax on bank transactions	Notional only, if permitted	Yes, if account is offshore

Physical and notional pooling are both well-established methods of liquidity management and the decision to choose one approach over another should be based on thorough analysis including tax review and organizational considerations. Many companies are initially attracted to notional pooling because of its conceptual simplicity and the fact that much of the work is done by the bank. As corporate thinking evolves to include regulatory issues and price, physical pooling generally becomes the more preferred choice. Our work with corporations and banks on pooling indicates that physical pools account for more than 80% of all pooling structures globally.

Some of the factors that account for this preference are:

- **The Euro Zone**—Countries within the zone can be handled through a single physical pool. This reduces the number of accounts which need to be maintained and the related accounting and administrative requirements. Further account reduction is expected with the full implementation of SEPA.

- **Cash Visibility**—Virtually all cash is visible through web-based balance reporting solutions which allow treasurers nearly instant access to all accounts in the pooling arrangement.

- **Corporate Systems**—The spread of enterprise-wide ERPs make the booking of intercompany loans for physical pooling a simpler task. Where ERP systems are not used, there are third-party TMS services which can easily handle the booking of loans.

- **Bank Systems**—Globally, and particularly in Europe, the banks have integrated and consolidated their operating platforms across regions. In some cases, even if an account is nominally maintained in one country, say France, the accounting system supporting the account may be physically located in the bank's European processing center which could be in the UK or the Netherlands.

Notional pooling can be a realistic approach for mitigating the costs of periodic fluctuations between positive and negative positions in short-term cash. It is also a convenient way for companies to capture the deposit/borrowing spread earned by financial institutions. From a cross-border perspective, notional pooling also works effectively if a company has just acquired overseas operations or where treasury has limited control over local banking arrangements but still wants to be able to manage global liquidity. The overlay banking structure required for the notional pool will not disturb the existing banking structure.

Notional pooling can be a realistic approach for mitigating the costs of periodic fluctuations between positive and negative positions in short-term cash. It is also a convenient way for companies to capture the deposit/borrowing spread earned by financial institutions.

Notional pooling is a practical tool in countries where there is a debit tax levied on cash payments from bank accounts. Physical pooling between separate legal entities would trigger the tax; so notional pooling is the logical choice. It is less effective as a solution when:

- The company has a long-term or permanent mismatch between cash positions. In this case, formal intercompany loans would be used as the most appropriate balancing mechanism.

- All operating companies are in a long-term surplus cash position. With this positive liquidity situation, the company should place excess cash in higher yield investment instruments, by currency. In this case, using ZBA arrangements in order to bring up all excess cash to single currency pools is the preferred option.

Notional pools that use existing banking arrangements can be quick and easy to implement. Physical pools require a more complex implementation but are less costly to operate and capture more of the company's liquidity. In both cases, implementation may take between six months and one year depending on the complexity and the resources devoted to the task by both the company and the pooling bank.

The final decision often comes down to two criteria: complexity and cost benefit. Notional pooling shifts much of the work to the pooling bank, which tends to increase costs and add to regulatory complexity. Further, many of the costs of notional pooling such as the notional conversion to a common currency are not priced explicitly and this lack of transparency can be expensive. However, notional pooling can be very effective as an overlay banking structure and for this reason continues to be an effective tool in the liquidity management arsenal.

IMPLEMENTATION ISSUES

Banking Structure

The degree to which the pooling structure will be integrated with the daily transactional requirements of the company is a factor in choosing an approach to pooling. This is because the most cost effective pooling solutions link the liquidity management benefits offered by pooling with the transactional services for receipts and disbursements required to operate a business in each country. The simple addition of a pool bank as an overlay without any change to the local banking structure adds considerable cost due to the extra layer of accounts required, transaction costs in moving funds to and from the pool bank and potential loss of interest on funds that are in-transit.

The degree to which the pooling structure will be integrated with the daily transactional requirements of the company is a factor in choosing an approach to pooling.

Using a single bank for both transactional banking and pooling in a region creates another set of issues. In this case the bank providing the pooling services may not have deep local capabilities in all of the countries in which the company operates. This leads to the need for correspondent banks, strategic partnerships or specialized network arrangements. These can work very well or be a source of ongoing headaches and hidden costs. Thus the design of the overall structure must take into consideration not just the pooling itself, but how it integrates with day-to-day working capital management.

Assessing the Costs

Broadly speaking there are four categories of cost associated with pooling: implementation, maintenance, transactional and opportunity.

1. Implementation costs assessed by banks include setup charges for the basic pooling system, out-of-pocket reimbursement for certain types of on-site technical support and license fees for any bank systems used. Depending on the bank relationship,

these charges may be waived. But as they are real costs to the bank, the bank will be careful to recoup costs in other areas to ensure that overall profit targets are met.

2. Maintenance costs may include account maintenance, statement rendition and software servicing/upgrading.

3. Transactional costs include wire and book transfer charges. The number of possible charges is limited only by the creativity of the bankers assessing them and the trick is to worry less about specific items and focus on the run cost of the pool. To do this, prospective pooling banks should be asked to prepare an estimated monthly run cost based on the proposed pooling structure and volumes. This will demonstrate how the quoted prices will be applied and can eliminate many unpleasant surprises.

4. Opportunity cost arises because in virtually any pooling arrangement the bank will have use of the company's funds for a period of time during which there may be notional conversions or other transactions. Further, the bank may provide account services for a nominal fee in return for providing pooling services at an apparently low cost. These low explicit costs hide significant opportunity costs such as:

    a. The rates applied to balances may be slightly below the rates a company could achieve in the money markets.

    b. A spread may be taken in the notional conversion of pooling currencies to the base currency of the pool. Where conversion is achieved through the use of interest rate differentials the interest rates may be less competitive than what a company could earn itself.

    c. The type of instrument for investing surplus funds and its tenor is selected by the bank, not the company.

    d. If the pooling bank does not provide the basic operating accounts used by the participants another layer of bank accounts is required. This may necessitate a manual transfer to the pool accounts or a loss of value if the transfer is automated.

    e. If there is a currency movement against the pool base currency, the parent company will have to purchase currency in order to bring the pool back to the zero level.

Finally, if the bank performing the pooling is not a direct member of the local payment and clearing systems within a given country, the cut-off times for investment may reflect the bank's need for an intermediary. This can change a late-afternoon cut-off time to midday, which, for a European pool means the loss of a full day's interest for US balances.

Pool Location for USD

For companies that maintain USD accounts throughout the world, the question often arises as to whether the pool header account should be located in the US or offshore in a favorable financial center location, such as London, Dubai or Singapore.

Considerations associated with locating a global USD pool in the US include:

- Fees related to current account overdrafts which are technically not allowed in the US.
- The need to sweep funds to an overnight investment or interest bearing account (usually in Cayman or Bermuda) to earn interest on surplus cash.
- Deposit insurance (FDIC) charges that will be assessed until at least 2013.
- Better access to the full range of payment instruments including Fedwire and ACH with their attendant lower costs.
- The inability of US entities to participate in a pool if they are a net user of funds because this would likely be viewed by tax authorities (IRS) as a deemed dividend.
- Improved visibility and access to funds for companies based on the west coast due to time zones.
- The potential to reduce pooling balances if the bank is required to maintain reserves on these funds.

For companies that maintain USD accounts throughout the world, the question often arises as to whether the pool header account should be located in the US or offshore in a favorable financial center location, such as London, Dubai or Singapore.

If the global USD pool is located offshore, keep in mind:

- Overdraft facilities are commonly available.
- There is no withholding tax on interest earned in bank accounts in most common pooling locations.
- Some banks offer the flexibility to receive funds into an onshore USD account and then sweep the funds to the offshore pooling location.

- If the pool is maintained in Europe it is possible to arrange intraday sweeps between the pool and the onshore USD accounts.
- USD accounts held offshore are not subject to deposit insurance fees—but reserve requirements do apply.

Structural Issues

It's important to review all domicile and structural arrangements and legal agreements that are already in place and which may impact a pooling structure. Examples include:

- The capital structure and documentation requirements pertaining to specific local regulations may limit the flexibility that a company has in using certain types of entities as the main header account holder. For example, if a finance vehicle, such as BV, is set up in the Netherlands with minimal capital, this may dictate that management fees cannot be charged, nor can the entity act as an agent in a pooling arrangement, which would give the BV treasury functionality. This raises concerns about thin capitalization and its consequences.
- When the main account owner is the treasury of a US parent, then subpart F restrictions will likely trigger treatment of pool earnings as deemed dividends. This effectively precludes direct participation by the US Corporate parent in a pooling arrangement.
- If a US subsidiary (not the parent company) is a net contributor of funds to the pool, for example it is collecting EUR from European customers; its collection account which will always be in a positive cash position can be a pool participant.

Pooling Providers

For single country, stand-alone pools an indigenous bank is often the preferred pooling provider. Their branch network, operating capabilities and likely roster of existing pooling clients give them a pricing and experience advantage. When operating on a cross-border basis with multiple currencies, the large global or regional banks have the most expertise. Because the global banks may not have an in-country infrastructure comparable to the indigenous banks in all countries, the global bank may partner with one or more local banks to provide required local transaction services.

While the regulations governing pooling systems are the same for each bank, the global banks tend to vary in their approaches reflecting different operating systems, technology infrastructure and particular focus and capabilities in a region. It is advisable to solicit pooling proposals from more than one bank—but only once you have worked out the desired account requirements and have a clear concept of the best liquidity and tax structure for the company's operations. Cash pooling is not an off the shelf service. So the recommendations a bank outlines and the description of service capabilities should be designed based on the bank's understanding of the company's unique business, financial and organizational requirements. (For a detailed discussion on preparation of RFPs see our White Paper *The RFP Process—A Treasurer's Guide*.)

> While the regulations governing pooling systems are the same for each bank, the global banks tend to vary in their approaches reflecting different operating systems, technology infrastructure and particular focus and capabilities in a region.

Global and Regional Pooling

Global pooling is a tempting concept that may not survive careful analysis. Businesses operate in different time zones with a large network of banks which makes it difficult to manage through a single pooling structure. Most companies establish regional pools in key locations that can take advantage of the intra-regional bank rules that frequently favor local countries. Further, the insolvency rules of some countries effectively restrict the ability of local affiliates to participate in any sort of pool.

Pooling on a regional scale is most common in Europe because of the Euro zone, reliable financial infrastructure and a favorable tax and regulatory climate. It is less used in Asia/Pacific, primarily for regulatory reasons and virtually unknown in Latin America due to FX restrictions and the withholding tax implications of intercompany lending. In the US pooling is achieved almost exclusively through physical means as IRS regulations can interpret notional pooling as co-mingling of funds. Also, the US does not have a banking environment that allows either overdrafts or interest to be paid on current accounts—the interest offset drivers for notional pooling in the first place.

TAX CONSIDERATIONS

Cash pooling can have significant tax implications and the interpretation and understanding of both notional and physical pooling can vary widely from company to company. The key point is that the decision on the specific approach to pooling, domicile and ownership of the pool header, legal entity and country participation will usually be driven by tax considerations. Treasury will act as the strategic partner in the evaluation process with responsibility for determining the best banking partners and overall account structure.

Favorable tax treatment is an important factor in evaluating what approach to take. Two primary considerations are:

- The content of the underlying agency agreement in place between the owner of the main pooling account e.g. an existing subsidiary or structure such as a BV or Swiss Holding Company.
- The presence or absence of withholding taxes in the country or countries where pooling is contemplated is influential in the choice of pooling method because charging and paying of interest may be either implicit or explicit.

Basic Requirements

Virtually all liquidity management structures, whether physical or notional must comply with the following three basic requirements from a tax perspective:

1. **Arm's-Length Interest Allocation**—All financial arrangements between participants, such as credit lines, cross-guarantees and interest rates should reflect an arm's-length, or market price. While the pool manager (Treasury) may have discretion in allocating the interest income and expense among participants, this interest allocation cannot be arbitrary. The concern is that the pool may be used to shift income from one jurisdiction or entity to another in order to reduce the tax burden.

2. **Business Purpose**—The entire structure must have a valid business purpose other than tax avoidance or the circumvention of non-tax regulatory restrictions. Pooling structures typically meet this requirement as the net lending and net borrowing positions of the participants are of a short-term nature and the primary purpose of the structure is the efficient management of liquidity.

3. **Economic Substance**—The participants must have formal, legal responsibilities surrounding their participation in the pool including the need to pay interest, suffer interest rate risk and the risk of default by a counterparty. Cross-guarantees, cross-indemnities and other rights of offset are protective measures used by banks that also serve to establish economic substance and need not be a concern as long as all participants are legitimate and solvent. Intercompany compensation at arm's-length rates with respect to guarantees provides additional support.

Other key tax issues that arise in setting up pooling structures include: characterization of interest, tenor of cash position, tax treaties, thin capitalization rules and withholding tax.

Characterization of Interest

The first step is to determine whether the owner of the main pooling account is acting as:

- **The principal for the group**—If so, the interest earned or charged will be considered to be intercompany interest, subject to withholding tax.

- **An agent for the participants**—Then the interest will be considered to be bank interest which is not subject to withholding tax in certain locations, such as the Netherlands and the UK. This does not govern how local tax authorities may view the interest paid to the pool participant if the subaccount is maintained in country.

The definition of interest is a key determinant of tax treatment and the type of interest will affect the allocation back to the participants and how they are taxed in their respective tax jurisdictions. Pool participants will receive and the pool-header will pay interest at an agreed-upon rate which can be equal to, less than, or greater than the rate that the pool header entity receives from the bank as long as it is arms-length and meets the standards required for transfer pricing purposes.

> An underlying tax exposure may exist in some jurisdictions if a pool participant has a net payable balance in the pool for a period of time. This net payable balance raises tax questions as to the recipient of interest payments on the net negative cash balance.

Tenor of Cash Position

An underlying tax exposure may exist in some jurisdictions if a pool participant has a net payable balance in the pool for a period of time. This net payable balance raises tax questions as to the recipient of interest payments on the net negative cash balance—the pool header or the other participants. This is a sensitive area, as often a pooling arrangement is set up as a method of automatically funding entities that are simply operating centers which do not receive funds arising from sales or service revenues. In this case tax direction is essential as there may be other ways to handle funding, such as cost plus, commissionaire arrangements or straight intercompany loans.

Tax Treaties

Every country has a network of treaties providing different levels of tax concessions for international transactions with the countries that are its trading partners. The level of concession depends on the treaty partner. Certain countries have a highly developed treaty network that facilitates operation of a treasury center/cash pooling arrangement. Their treaty network provides benefits such as low or no withholding tax on cross-border interest, dividends and capital gain payments.

The simple existence of a treaty network does not automatically guarantee treaty benefits to all participants. For a multinational to qualify for the treaty benefits it must be a resident company in each of the treaty countries. That is, it must have a substantial business presence in the treaty country. Tax treaties contain rules to protect against sham operations, nominally resident in the country, but actually set up to take advantage of a favorable treaty benefit. For example, some rules attempt to determine the true identity of the party-in-interest or ultimate beneficiary from a series of intercompany loans or other transactions. Advance planning is important in getting the most out of tax treaties. This would include the use of "capital blockers" in which funds are contributed as equity and withdrawn as loans. These rules must be reviewed in detail and applied to a company's particular situation.

The simple existence of a treaty network does not automatically guarantee treaty benefits to all participants. For a multinational to qualify for the treaty benefits it must be a resident company in each of the treaty countries.

Location of domicile is another consideration. Often, units in tax haven locations such as the Cayman Islands and Bermuda, may not be able to participate in a pooling structure. This requires an additional review by both tax and legal as often a US based company may have multiple entities registered in offshore jurisdictions. Quite frequently Treasury is not even aware of the residency situation.

The domicile of the bank accounts supporting the pooling does not need to be the same location as the entity that is controlling the accounts. Simply put, it is not necessary to physically locate the bank accounts supporting a Swiss company in Switzerland if the banking infrastructure in the UK is more suitable. The Swiss company can hold a non-resident account in the UK. Tax and other logistical drivers determine the location of the pooling entity.

Withholding Tax

Cross-border treasury management involves the payment or receipt of fees for services and interest payments/receipts on lending or investment activities. These revenue and expense streams are often subject to withholding taxes when the recipient of the service pays money to a treasury service provider or pool header located in another jurisdiction.

The withholding tax leakage will depend on the income tax treaty network between these two jurisdictions. If a tax treaty exists, the withholding tax on the interest payment can be reduced or eliminated. For example, when a US Company pays interest expense to a European treasury center, the withholding tax can be reduced from 30% to zero in many instances if there is a tax treaty in place between the US and the European country in which the treasury center is located. Conversely, similar payments to an Asian or Latin American treasury center will result in higher taxes, in many instances at the full 30% rate.

> Cross-border treasury management involves the payment or receipt of fees for services and interest payments/receipts on lending or investment activities.

Treasury service fees can also be subject to a withholding tax depending upon the location of the service recipient and whether or not a treaty exists with the pool manager's (entity holding the pool header account) jurisdiction. Any profit repatriation from this pool header company to its shareholder in the form of a dividend will be subject to withholding tax considerations. For dividends, the withholding taxes could be reduced either under the domestic tax legislation of the Header Entity's jurisdiction or under the tax treaty between the Header Entity's jurisdiction and the jurisdiction of the shareholder.

For example, there can be deemed dividend issues in any pooling arrangement whether notional or physical. Deemed dividends arise when the allocation of the interest benefits or cost of the pool to each participant takes place at arbitrary rates with the effect of avoiding taxation. Because intercompany loans are in place with a physical pooling arrangement and arm's length interest is charged, paid and documented there is a high degree of transparency in the pool. With a notional pool the situation from a tax perspective is more ambiguous and therefore might be a source of concern to many company tax directors and their advisors.

SUMMARY

The complexities of designing and implementing pooling arrangements may cause some to question the efficacy of pooling as an approach to liquidity management. Despite these concerns, once established, pools are relatively straightforward to manage. Further, the ability to efficiently use all company liquidity to manage varying deficits or surpluses across the enterprise makes the work to implement pooling worthwhile. It is a smart way for treasury to improve the balance sheet but requires careful assessment and cost benefit analysis, close collaboration with tax, an evaluation of overall banking requirements and a focused project approach to select the correct structure and banking services. So although it is not a simple evaluation or a quick fix solution, the benefits will likely outweigh any initial hurdles.