HMRC guidance introduced on cash pooling arrangements

February 17, 2017

In brief

HMRC published guidance February 6th on the transfer pricing aspects of cash pooling. The guidance, which was prepared following several months of drafting, provides examples illustrating the potential areas of challenge associated with a cash pooling arrangement, in particular in light of the recent OECD BEPS publications. The guidance also provides insights into how a cash pool is defined; the key participants in the cash pool; how to set interest rates for the pool; how to remunerate the pool leader; withholding tax for cash pools; and the potential implications of long-term balances remaining with a pool for a sustained period. Companies should consider whether their cash pooling arrangements align with this new guidance as this will be influential in any UK tax audit.

In detail

The new guidance, which is split across several chapters (as outlined below), provides insights as to the areas HMRC may examine in relation to a cash pooling arrangement for a UK cash pool leader or UK cash pool participant.

Section 1: Introduction to cash pooling

Provides a brief overview of how cash pooling arrangements work and outlines the operational benefits of a cash pooling arrangement.

Section 2: Legal and commercial arrangements

Distinguishes between a notional and zero balancing pooling arrangement and emphasises the need to review legal documentation carefully in order to determine the specific nature of the pooling that is taking place. The section also introduces the concept of cross guarantees and the increased risk this places on depositors to the pool.

Section 3: Setting interest rates on an arm's-length basis

Establishes the basis upon which benefits are allocated within most cash pooling arrangements (i.e., through the use of borrowing and deposit rates), although also acknowledges cost plus remuneration for the cash pool leader as an alternative. This section flags the key issue in applying the arm's-length principle to cash pooling arrangements — namely, that such arrangements are not entered into by independent enterprises. The section further discusses the recent OECD Report on Aligning Transfer Pricing Outcomes and Value Creation (October 2015) and how group synergies should be shared within a group, in particular the need to assess this initially but also over time, and the move away from a one-sided approach to pricing.

Section 4: Short- and long-term balances in the pool

Defines the aspects of cash pooling arrangements that can impact pricing considerations. In addition, this section provides examples of situations where the activities of participants to a cash pooling arrangement might differ from those that would have existed

between independent parties (e.g., the degree of monitoring and short/long-term balances).

Section 5: UK companies as long term-depositors

Identifies the scenario whereby a UK company has material deposits in a cash pool that have been in place for longer than 12 months and outlines the considerations that should be taken into account when analysing such a scenario (including funding needs/cost, functional activities of the depositor, and rationale for holding cash). This section also discusses the additional pricing considerations associated with cross-guarantee arrangements and the potential merits of the use of a profit-split approach for splitting the pool benefits.

Section 6: UK company as long-term borrower

Outlines that this is unlikely to be an area of material risk from a UK tax perspective given the underlying assumption that the rate at which the borrower is able to borrow should be more favourable than the rate the borrower could have obtained from the market. The section flags the need to consider borrowings from a cash pool as part of a wider thin capitalisation assessment of the UK company and the need to understand the withholding tax clearance position with respect to longer term balances.

Section 7: UK company as cash pool header

Details the additional considerations for a UK cash pool header, over and above the spread between borrowing and deposit rates within the pool. This includes holding excess deposits/having a net funding position and liquidity risk associated with short-term deposits/long-term borrowing being funded from the pool.

Section 8: Cash pool header and the arm's-length principle

Reflects on the monitoring requirements for a UK cash pool header to ensure short-term balances do not become long term in nature along with other considerations (such as the nature and purpose of the funding). This section also describes the need to re-price balances in circumstances where the substance of the arrangement differs from its legal form (i.e., that a long-term balance which is legally described as a short-term balance).

Section 9: Netting considerations

Assesses the ability for a pool to net balances with reference to the Bombardier Danish tax case (concluding that interest should be calculated on the net position if the participant has both deposits and borrowings with the pool). The section distinguishes between entity netting and country nettings, the latter not being as straightforward and with no obligation to net unless this is part of the legal/commercial arrangements. The section also highlights the issues associated with parent/subsidiary pool participants in the same territory and also netting different currency balances.

Section 10: Risk assessment/compliance

Outlines the key documents the CRM/caseworker should assess, the documentation requirements per the OECD Guidelines with respect to pricing of the pool, and the balance sheet position of a UK header with regard to deposit and borrowing positions.

The takeaway

The focus of the HMRC guidance makes clear that additional scrutiny likely will be applied going forward with regard to cash pooling arrangements involving UK participants. To the extent the appropriate degree of rigour has not been applied to pool pricing, documentation, or monitoring, these areas should be addressed now in order to ensure the best possible defence under a potential UK tax audit.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

PwC UK

Graham Robinson, *London*
Finance and Treasury Tax
+44 (0)20 7804 3266
graham.x.robinson@pwc.com

Loic Webb-Martin, *London*
Transfer Pricing
+44 (0)20 7213 5451
loic.webb-martin@pwc.com

Dan Pybus, *London*
Transfer Pricing
+44 (0)20 7213 1359
daniel.j.pybus@pwc.com

Transfer Pricing Global and US Leaders

Isabel Verlinden, *Brussels*
Global Transfer Pricing Leader
+32 2 710 44 22
isabel.verlinden@be.pwc.com

Horacio Peña, *New York*
US Transfer Pricing Leader
+1 646 471 1957
horacio.pena@us.pwc.com