# Cash pool: from A to Z (1) (2/27/19)

Latvia’s corporate income tax (CIT) reform has triggered discussions about the concept of cash pooling, which is still one of the top three uncertain areas in terms of CIT treatment. To understand why there is so much buzz about this, we offer a series of articles exploring the tax and legal implications of cash pooling, and relevant transfer pricing issues.[1]

What is cash pooling?

A cash pool is a structure that involves several related bank accounts with their balances aggregated to optimise interest paid or received and to improve liquidity management. Cash pooling enables corporate groups to minimise their expenses through economies of scale.

In a cash pooling arrangement, group companies regularly transfer their surplus cash into a single bank account (the “master account”) and, in return, may draw on the funds in that account to satisfy their own cash flow requirements from time to time. The master account is usually held by the parent or by a treasury company established specifically for this purpose.

There are two ways of pooling cash: physical and notional. Both pooling techniques require that a single bank be used for each pooling structure.

Physical pooling

A physical cash pool is a concentration account used for liquidity management. Surplus funds are physically concentrated into the account to maximise interest. Deficit accounts are covered by transfers from the cash pool to minimise overdraft interest.

Physical pooling can be used across multiple companies located in the same country, or in different countries but in the same currency. The movement of funds between the participating companies is accounted for via intercompany loans.

Participants in the pool maintain their own bank accounts as subaccounts linked to the header account. The participants conduct their day-to-day banking business as usual. The header account is generally a different company from the operating participants and could be the parent depending on the country of domicile. This is illustrated in the diagram below showing the account positions before and after pooling.

Whether physical pooling takes place within a single country or across borders, common concerns include cut-off times for transactions, their actual cost, and the ability to track intercompany loans associated with physical pooling.

Notional pooling

A notional cash pool is a structure that involves several related bank accounts with their balances aggregated to optimise interest paid or received. The bank looks only at the total balance of accounts in the notional pool when calculating interest, but there is no physical movement of funds.

Notional pooling achieves the same result, but it’s accomplished by making balancing entries in a set of virtual accounts, with no changes to the bank accounts held by the companies. The bank provides an interest statement showing the net offset similar to what would have been achieved with physical pooling, but no intercompany loan is required to account for the offset. Notional pooling can be applied on a cross-currency basis.

Here is an example of A, B and C, three subsidiaries owned by the parent. The bank offers a credit interest rate of 2% and a debit interest rate of 4%.

The example shows a benefit of 1.5 percentage points from notional pooling. The company earned 3% on its total position without pooling, and 4.5% resulted from pooling, as it eliminated the bid-offer spread. The parent sometimes shares this benefit with the participants as an incentive to enter into the agreement.

While this is a smart way for treasury to improve the balance sheet, it requires careful assessment and cost-benefit analysis, close liaison with tax consultants, an evaluation of overall banking requirements, and a focused project approach to select the correct structure and banking services. If set up correctly and with support from tax consultants, a cash pool can provide the company with significant ongoing benefits.

Our upcoming articles will deal with the tax and legal implications of a cash pool.

---

[1] This article contains information from Treasury Alliance Group – Cash Pooling Guide