Cash pool: transfer pricing aspects (2) (2/43/19)

To pick up where we left off about the transfer pricing aspects of a cash pool, this article explores ways of setting fees for cash pool members, including the treasurer, according to the OECD Base Erosion and Profit Shifting (BEPS) discussion draft on financial transactions published in July 2018 ("BEPS report").[1]

Setting the treasurer's fees

As with other related-party transactions, fees payable in financial (including cash pool) transactions depend on the facts and circumstances of the controlled transaction. To set an arm's length fee, we need to analyse the taxpayer's functions, risks and assets, as well as the subject matter of the transaction and comparability of any other factors driving the price of transactions. The BEPS report explains that findings from the transactional and functional analyses result in two approaches to setting the treasurer's fee:

1. as a percentage of the spread between deposit and loan interest rates, or
2. by adding a markup to the treasurer's costs for the service function.

According to the BEPS report, a treasurer that lends cash to related parties and takes financial risks, such as conducting a preliminary assessment of the borrower's credit risk, deciding about depositing free cash, and taking credit risk and liquidity risk, is entitled to a relatively high fee adequate to the functions and risks, expressed as a percentage of the spread.

If, however, the treasurer in fact works as a treasury that coordinates lending to related parties, without taking substantial risks as those are taken by either cash pool members or third-party banks, the treasurer can earn a service fee calculated as the treasurer's costs plus a markup.

Setting fees for cash pool members (except the treasurer)

Fees for the treasurer and cash pool members are set according to the substance and circumstances of the transaction. This can be equated to potential interest revenues or interest costs arising in financing transactions with an unrelated company such as a bank. The BEPS report sets out three approaches to setting fees for cash pool members:

1. Adapting the interest rate to all members – this method is appropriate where debtors and creditors are equally necessary to create cash pool synergies. If the cash pool has debit balances as well as credit balances, then it may be useful to provide a benefit to borrowers and lenders by linking the interest rate to the amount of cash deposited in or borrowed from the cash pool.
2. Applying a single rate to all members – another way of setting fees for cash pool members is a single rate of interest on deposits and loans for all. This approach is recommended where there is no substantial difference between the financial and commercial positions and, above all, credit ratings of the members.
3. Allocating benefits to lenders only – where depositors take credit risk, the cash pool benefit can be distributed among the creditors. Allocating benefits to lenders is recommended where depositors risk their own capital and are therefore entitled to a benefit for risks inherent in using their capital. This approach is recommended where the treasurer performs the treasury function without taking credit risk.

The final article in this series will look at what data and sources are used in practice for setting fees (interest rates) for cash pool members depositing and borrowing cash.

[1] This article includes information from BEPS Actions 8–10, Financial transactions