Cash pool: statutory aspects (1) (2/30/19)

Credit institutions operating in Latvia offer their customers an opportunity to take part in cash pools, but the process of setting up and maintaining a cash pool involves some tax and legal risks, as well as raising many questions, which may deter persons from cutting their costs and managing their cash efficiently. This instalment in our series of articles analyses the legal risks and implications of a cash pool. Some of the aspects of setting up and managing a cash pool will depend on whether it is intragroup or combines funds of unrelated parties. This article explores the two types of cash pooling and their legal implications.

Setting up a cash pool

Latvian law allows any entity to set up a cash pool using the services of a financial institution. But the law does not lay down any special rules to govern such a legal relationship, so this may raise some valid questions. A cash pool operates under an agreement between companies for moving their cash. As with other transactions, a cash pool is governed by the Civil Code, whose chapter dealing with the law of obligations applies also to cash pooling transactions, as the principle of free contracting allows persons to freely determine how their cash moves.

Before entering into a cash pool agreement, it is important to check that the persons representing an entity are duly authorised to act for it. As with other commercial transactions, a cash pool agreement must be lawful for it to be valid and to avoid any serious financial and legal consequences if it is later found to be invalid because it was concluded unlawfully, for example, the owner’s consent was not obtained before signing.

This leads to the conclusion that the law imposes no restrictions on setting up cash pools, but the entity’s governance documents may lay down individual restrictions the existence of which should be verified before undertaking such activities.

Does a cash pool need any permission from government agencies?

A cash pool is a set of private obligations that is not subject to licensing or any other type of authorisation by the regulators, but certain activities within a cash pool may create such a requirement.

The Financial Instruments Market Act defines a credit institution as a company formed for taking deposits and other repayable funds and for making loans in its own name. The company acting as intragroup treasurer will be considered a credit institution only where deposits are taken and loans made to the public at large, i.e. we can identify a public element in the treasurer’s business.

Persons operating cash pools should also consider the circumstances in terms of anti-money laundering and counter-terrorism and proliferation financing. Financial institutions may request information about the origin of funds, including borrowings from the cash pool. For this reason we need to be able to prove the origin of funds of all the cash pool members, since the pooled cash may become the property of a person subject to an investigation.

The State Revenue Service (SRS) may also scrutinise the cash pool and seek to withhold taxes on its transactions, but it is important to assess the substance of those transactions and correctly identify the

applicable tax rate. The SRS has not published any official comments or guidelines about cash pools, but practice suggests that such transactions are usually treated as short-term or long-term loans with appropriate tax implications. There is no requirement for registering a cash pool with the SRS.

(to be continued)