

# Cash pool: transfer pricing aspects (1) (1/34/19)

Multinational enterprises tend to set up cash pools to optimise disposable intragroup funds and minimise their reliance on external financing. But setting up a cash pool creates the need to prove the arm's length nature of cash pool transactions and, possibly, to prepare transfer pricing (TP) documentation. This series of articles will be exploring key TP considerations regarding cash pool transactions between related parties in the light of Latvian TP rules and best practices recommended by the OECD BEPS project.

## Transfer pricing rules in Latvia

With Latvian legislation being silent about a TP analysis of cash pool transactions, those are subject to the same requirements as other financial transactions between related parties. To assess cash pool transactions for compliance with the arm's length standard and to prove that the intragroup commercial and financial conditions do not differ from those that would be applied in similar transactions between unrelated companies in similar circumstances, the taxpayer should carry out a TP analysis under paragraphs 7-19 of the Cabinet of Ministers' Rule No. 677, *Applying provisions of the Corporate Income Tax Act*. If specified criteria are met, the taxpayer should prepare mandatory information (TP documentation) to be filed under section 15.2 of the Latvian Taxes and Duties Act.

## The rationale behind a cash pool and its TP aspects

A cash pool aims to optimise working capital management in a group of companies and minimise their reliance on external financing as well as its price where this is still required. The operations and types of cash pools are described in our [Flash News edition of 2 July "Cash pool: from A to Z"](#), which implies the following types of related-party transactions:

- Depositing in the cash pool (by any cash pool members with a working capital surplus);
- Borrowing from the cash pool (by any cash pool members with a working capital shortfall);
- Cash pool management (normally by the treasurer).

For TP purposes, the treasurer and the cash pool members should be receiving and paying an arm's length fee for each type of related-party transaction.

Depending on the results of the functional and risk analyses, a number of scenarios are possible for determining an arm's length fee for cash pool transactions. In practice we commonly see amounts deposited in a cash pool at bank deposit rates or the current EURIBOR and borrowings from the cash pool at various bank loan rates, while the treasurer often keeps the spread because deposit rates are normally lower than loan rates. This practice involves a number of TP adjustment risks because all cash pool transactions should be assessed according to their economic substance. For example, international case law<sup>1</sup> implies that the treasurer's transactions with the bank are not accepted as comparables in defending cash pool prices for TP purposes because credit risk (the borrower's credit rating) is considered the main criterion for comparability.

It is crucial that TP analysis should recognise the following points:

1. Depositing current assets in a cash pool is not considered equivalent to depositing funds at a bank because the cash pool normally has a lower credit rating than the bank;
2. Borrowing from the cash pool is mainly treated as short-term borrowing because the main purpose

of a cash pool is optimising the use of working capital rather than investment financing.

And the mere fact that the rates (on deposits and borrowings) available in a cash pool are better than what a bank offers to the company independently, is not sufficient to prove that the cash pool transactions are arm's length. It is also crucial that taking part in a cash pool should benefit the company in a reasonable proportion to its risks.

For example, a treasurer that takes no credit risk and performs only administrative functions does not qualify for any potential benefit from the cash pool, such as the spread. One solution is avoiding any spread and paying the treasurer a fee for administrative functions.

As we can see, it is very important to properly document cash-pool transactions and use appropriate comparables.

Next, we will be exploring how to set fees for the treasurer and cash pool members.

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<sup>1</sup> Source: Denmark vs Bombardier, October 2013, Administrative Tax Court