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Cash Pooling in Central & Eastern Europe

A CMS Corporate Publication

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Introduction

Cash pooling enables corporate groups to minimise expenditure incurred in connection with banking facilities through economies of scale.

Under a cash pooling arrangement, entities within a corporate group regularly transfer their surplus cash to 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 company or by a "treasury company" established specifically for this purpose. Depending on the type of cash pooling arrangement, the participating entities may transfer either their entire cash surplus ("zero balancing"), or cash exceeding a certain surplus level ("target balancing"). In general, all entities participating in the cash pooling arrangement will be liable for any negative balance on the master account, irrespective of the amount they have contributed.

Transfers and draw-downs of funds to and from the master account by the participating companies have the nature of the grant and repayment of intra-group loans.

In addition to physical cash pooling, there is also "notional" (also known as "virtual") cash pooling. This does not involve the physical transfer of funds, but rather the set-off of balances of different companies within the group, so that the bank charges interest on the group's net cash balance. This optimises the position of the group as regards interest payments, but does not achieve optimal allocation of liquid funds as between the group members.

Notional cash pooling will not result in the creation of intra-group loans, since funds are not physically transferred. As such, many of the risks outlined in this brochure do not apply to a purely notional cash pooling arrangement. In practice however, a notional cash pooling arrangement will frequently involve the grant of cross-guarantees and security by the participants to the bank, in order to maximise the available overdraft facility. To this extent, many of the risks outlined in this brochure could be relevant, even if the cash pooling arrangement is predominantly notional in nature.

The specific structure of individual cash pooling arrangements can vary. For example, transfers to the master account may be undertaken by each participating group member individually or may instead be undertaken automatically by the bank on the basis of a power of attorney given by the relevant group company.

In addition to the facility agreement with the respective bank, each participating group company will usually enter into a "cash pooling agreement". These agreements must be carefully structured in order to minimise the risks of civil or criminal liability of the participating group companies and their officers. Tax issues must also be carefully considered when structuring cash pooling agreements.

This brochure provides an overview of the risks of civil/criminal liability associated with cash pooling in the various jurisdictions in which CMS is represented in central and eastern Europe, and discusses the various means by which such liability may be avoided.

Bulgaria

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1. Legal framework for cash pooling

In Bulgaria there is no specific legislation on cash pooling. Cash pooling arrangements should therefore comply with the general corporate and banking rules on shareholder loans, security interests and company solvency, amongst others.

In addition, whilst 'virtual' and 'physical' cash pooling are legal in Bulgaria – the practice of 'physical' cash pooling being more common – Bulgarian court practice (particularly in the area of company insolvency) is still at a developing stage. As such, there are inconsistencies in the law, making the legal risks associated with cash pooling less predictable. Cash pooling arrangements must therefore be carefully structured and the applicable legislation strictly observed.

a) Directors and shareholders: maintaining solvency
The directors of a company are obliged to perform their duties and exercise their powers in the interest of the company and its shareholders, and with the care of a prudent businessman. This also includes the obligation of the directors to ensure that the company is solvent. Where the directors fail to manage the affairs of the company with the care of a prudent businessman (e.g. by entering into risky transactions outside of the normal course of business, such as poorly structured cash pooling arrangements) with the consequence that the company has become insolvent, the directors will be criminally liable and responsible for any loss that occurs to the company.

In a cash pooling arrangement, a specific conflict of interest that may therefore arise, and which could put the director in breach of his duty to the company and it shareholders, is where he is a director of more than one of the participating companies. To ensure he meets the due care standard, he must take adequate steps to ensure that each company:

— is able to seek repayment of any funds it has contributed to the cash pool; and

— is able to realise a benefit from partaking in the cash pool (such as preferential interest rates or easy access to liquid finance).

Furthermore, under tort and insolvency law, a director may be jointly and severally liable for the unsatisfied debts of the company if a breach of his due care standard has forced the company into insolvency. This liability can also extend to a majority shareholder if it has influenced the directors in a way that is not in the interest of the company's creditors.

Directors and shareholders therefore need to be careful that, so far as is possible, the management of the cash pooling arrangement is without prejudice to the solvency of the company. An example of where liability may arise is when a parent company, in need of liquidity, demands that a subsidiary contribute funds to the cash pool account for the parent company's withdrawal. If the effect of such a transaction is to cause the subsidiary to have its own liquidity problems, resulting in insolvency, then the directors may be liable for failing to refuse the parent's demand, and the parent liable for making and enforcing the demand.

b) Insolvency process
It should be noted that if a company does become insolvent then, within 30 days of the initial date of insolvency, the directors must initiate insolvency proceedings. A failure to comply can result in criminal liability.

In addition, once the insolvency process has started, shareholders can be obliged to refund all deposits and loans received from the insolvent company in the period of three years preceding insolvency, if such deposits and loans were concluded on interest rates below market value. Directors should factor in this possibility when creating cash pool arrangements; the insolvency of another participant, and the recall of its deposits and loans, may affect the liquidity of their own company.

c) Capital maintenance
Bulgarian capital companies, both OODs (limited liability companies) and ADs (stock corporations) must observe the following capital maintenance requirements:

(1) the net assets of a company should not fall below the minimum registered share capital of the company (currently BGN 2 (EUR 1) for an OOD and BGN 50,000 (EUR 25,000) for an AD).

Directors should therefore be careful to ensure that a company's contributions to a cash pool do not cause it to enter into a negative equity situation, particularly if the contributions may not be recoverable (e.g. due to the insolvency of another cash pool participant).

(2) distributions to shareholders are only allowed where the net assets of a company exceed its registered capital and mandatory reserves, and can be up to the amount of such excess. However, so long as the loan amount is fully recoverable inter-group loans in a cash pooling arrangement will not be considered a hidden distribution to shareholders and do not fall within this requirement.

(3) a parent company may only: (i) hold cash funds of its subsidiaries if the deposited funds do not exceed three times the registered share capital of that subsidiary; and (ii) extend loans to a subsidiary if the aggregate amount of such loans does not exceed 10 times the registered share capital of the parent company. Deposited funds and loans exceeding these thresholds are invalid and the excess amount must be refunded.

This will clearly have implications for cash pool arrangements where the parent company's name is on the cash pool account. Subsidiary deposits into it, and withdrawals from it, should therefore be carefully recorded to ensure there is no breach of the rules. Especially because any breach may result in the Bulgarian tax authorities not recognising the interest payments on the deposits or loans as being tax deductible.

d) Other matters to be considered
— Parent-subsidiary loans to insolvent participants will rank last in a winding-up

— Intra-group security provided by a participant in the 3 years prior to becoming insolvent may be declared invalid, depending on the circumstances

2. Legal structure and reduction of risks

a) Cash pooling agreement
In order to reduce the risk of liability associated with a cash pooling arrangement it is advisable that a cash pooling agreement is entered into by the participants, to achieve clarity as to their rights and obligations and thereby reduce legal risks. However, as noted above, insolvency law and practice is still being developed in Bulgaria, and as no specific cash pooling legislation has been put in place, it is not possible to eliminate all risks.

(1) Risk evaluation before signing the cash pooling agreement

It is important that the directors of the participating companies are assured that the benefits of the cash pooling arrangement outweigh any risks. The solvency of the other participants will be a key part in deciding this, for the reason that the insolvency of one could affect the solvency of all. Conflicts of interest (as noted above) should always be carefully considered.

(2) Right to information

The companies participating in a cash pooling arrangement should seek to have the right to up-to-date information on the liquidity and solvency of the other participating companies. An efficient and effective way of ensuring this may be for the cash pooling agreement to contain an obligation that the parent company provide the participating companies with monthly consolidated

financial statements for the group as a whole, whilst each participating company should have the right to inspect the cash pool accounts.

It is also advisable that an obligation is placed on each company to immediately notify all the other participants if the company's solvency is threatened. This will enable the directors of the other companies to make a timely decision as to whether to terminate their companies' participation in the arrangement.

(3) Right to terminate the cash pooling arrangement

The agreement should contain a right for a company to terminate the cash pooling arrangement at any time, and to be repaid (within 24 hours) any funds it has contributed to the cash pool. This is to enable a company to leave the arrangement where it is exposed to the insolvency of another participant, whilst allowing companies with insolvency issues to seek the speedy return of liquidity.

In addition, it may be advisable to contain a provision in the agreement that a company experiencing solvency problems is obliged to terminate its participation in the cash pool, by repaying all inter-group loans and reclaiming deposited funds. However, this must be done with consideration of the limitations on payments to shareholders prior to insolvency (noted above).

b) Cash pooling agreements and facility agreements
Should the cash pooling transaction be structured so that each participant must enter into an individual facility agreement with the bank, then the terms of the group cash pooling agreement must work in sync with the individual facility agreements. In addition, there are some specific issues to consider in relation to the facility agreements.

(1) Termination rights of individual participating companies

The group cash pooling agreement may state that only the parent company can submit a valid legal notice to the bank in respect of the cash pooling arrangement. However, it is important that this rule does not prevent an individual participating company from terminating the facility agreement to which it is party. The group cash pooling agreement will therefore need to be drafted with an exception for this.

(2) Joint and several liability and security

The facility agreements may provide that the participating companies are jointly and severally liable for any negative balance on the master account, and require intra-group security for the same. In addition, the standard terms and conditions used by banks in Bulgaria contain provisions creating liens over all the accounts of each group company. If possible, the participating companies should avoid such joint and several liability and security and the lien creating provisions of the standard terms and conditions. If this is not possible then an individual company's liability should be restricted, at the very least, to the lesser of: (i) the actual amount of funds withdrawn from the cash pool by that company; and, (ii) the amount by which that individual company's net assets exceed its registered share capital and mandatory reserves; otherwise the capital maintenance requirements may be breached.

(3) Liability on a sale of a group company

If a company that has participated in a cash pooling arrangement is sold, the seller will usually ask for an indemnity for potential liabilities in connection with the arrangement. One such liability (and indemnity) may be for capital maintenance matters, since the purchaser will be liable as an incoming shareholder for any payments previously made in contravention of capital maintenance provisions.

3. Tax issues

The following Bulgarian tax rules may have particular importance for the structuring of the cash pool arrangements.

a) Transfer pricing
The interest income of an intra-group lender will be included in the profits of that company, which are subject to a 10% corporation tax rate. On the other hand, the interest paid by the intra-group borrower will normally be deductible from the company's profits for the purposes of corporation tax.

However, the interest rates and the terms of the intra-group loans must be at arm's length (i.e. market level). Otherwise, transfer pricing adjustments can be made by the tax authorities. Such adjustments may result in a decrease of the interest income of the lender, and the non-deductibility of the interest expense of the borrower, if the interest rate exceeds market levels.

In addition, the interest paid by a Bulgarian company to a foreign company is subject to 10% withholding tax, unless an exemption is available under a double tax treaty. For such an exemption to apply, the interest rate must be agreed at market value or else it may be subject to an adjustment – usually an increase in the interest rate where the value was too low.

b) Hidden distribution of profits
The payment of interest by a subsidiary to a parent company may be classified as a hidden distribution of profits for tax purposes, if such interest exceeds fair market levels – or if at least three of the following conditions are fulfilled:

— the amount of the loan exceeds the amount of the subsidiary's equity;

— the repayment of the principle or the payment of the interest is not subject to fixed terms;

— the repayment of the principle or the payment of the interest or the amount of the interest depends on the amount of the profits of the subsidiary; or

— the repayment of the loan is subject to the payment of other debts or the payment of dividends.

If the interest payments are classified as a hidden distribution of profits, this would have the following consequences:

— the relevant interest expense will not be deductible from the profits of the subsidiary for corporation tax purposes;

— the subsidiary will be liable for a penalty amounting to 20% of the hidden distribution;

— the income from the distribution will not be eligible for deduction from the parent company's profits for corporation tax purposes (it normally would if the subsidiary is based anywhere within the EU); and

— the distribution will not be eligible for an exemption from withholding tax (it normally would if the parent is based within the EU).

c) Thin capitalisation
Under the thin capitalisation rules, the deductibility of interest will normally be limited to the total amount of: (i) the interest income of the company; and, (ii) 75% of the company's profits before interest and tax. If the company is making a loss, the deductibility of interest is limited to the interest income of the company.

In addition, if the company's debt to equity ratio is 3:1 or lower, the interest will be deductible in full – regardless of the amount of the interest income and the profits of the company.

Croatia

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1. Legal framework

a) Introduction
Cash pooling is not a concept recognised by the Croatian statutory framework. There is also no case law to define cash pooling in any detail.

Nevertheless, cash pooling is legal and practised in Croatia as part of regular banks' services. Indeed, cash pooling was developed and is frequently practised between banks and local authorities (municipalities and cities, amongst others).

The restrictions that apply to cash pooling refer to cross-border cash pooling. Croatian entities with their seat in Croatia are generally allowed to have bank accounts with banks also seated in Croatia. However, having an account opened with a foreign bank (meaning a bank with its seat outside of Croatia) requires an explicit permission. Therefore, cash pooling that involves a foreign bank as the cash pooling host will not be legal without permission.

b) Shareholders' loan provisions
As cash pooling is, by definition, always an intra-group loan, legal requirements as to shareholders' loans may apply. Certain restrictions as to shareholder loans should therefore be considered. For instance, when a company requires additional equity and the shareholder, instead, grants a loan to the company, such shareholder loan shall (in the company's insolvency) be subordinated to third party loans. If such loan is re-paid and the Croatian insolvency procedure is initiated against the company within a term of one year of repayment, the shareholder must return the re-paid loan to the company (and raise a claim in the insolvency procedure). However, it must be noted that this only applies to instances where a prudent shareholder would not have granted a loan to the company and would, instead, have provided the company with additional equity.

Furthermore, a joint stock company is forbidden from granting a loan to its shareholders or third persons for purchase of shares in itself. Funds placed into the cash pool by a subsidiary must therefore not be used by the parent company to obtain further shares in that subsidiary.

2. Types

Cash pooling may be (1) intra-company or (2) within a group. Each of these can be based on either the "zero-balance" or the "notional pooling" arrangement.

In the case of the zero-balancing method, funds on each of the regular accounts are transferred to the master account by the end of the day. In the case of notional pooling, there is no transfer of funds. Instead, the balances of each participating account are effectively considered as one, and interest is paid on the overall (settled) amount for the favour of the master account.

a) Intra-company cash pooling
It is common in Croatia that big institutions have several regular bank accounts and several separate accounts for its organisational parts – which operate separately, with independent balances. If there are differences between those accounts (i.e. some have net credit positions, whilst others have net debit positions), cash pooling may significantly reduce costs.

b) Group cash pooling
In a group of companies, each group company enters into an agreement with a bank whereby the bank is authorised to mark one of the participating accounts as the master account. Again, in such instance cash pooling may significantly reduce costs if there are differences between the accounts (i.e. some have net credit positions whilst others net debit positions). However, it should be noted that there are risks and liabilities if the profits of the participating companies are 'silently' transferred within the group.

3. Liability risks

a) Director's liability
Liability may arise whenever several companies enter into a cash pooling agreement. The agreement should be in favour of all the companies entering into it – not for just one or some of them.

The main issue is that participating cash pooling accounts are mutually settled (i.e. net debit is set off against net credit). This may cause damage to a participating company if its positive cash flow is used for settling the negative cash flow of the other participating companies. Any director of a participating company should therefore act with the due care of a prudent businessman, and should therefore not enter into agreements that are predictably disadvantageous for the company.

Indeed, unless the risks are outweighed by the benefits, any director should not enter into a cash pooling agreement where the company does not receive an adequate remuneration for its liabilities or contributions. Of course, it is unlikely that any participating company would file a claim against the directors of another participating company (as they are likely to all be members of the same group), but there are instances where creditors of a subsidiary could directly claim damages from the directors of the subsidiary, predominantly in insolvency scenarios.

b) Capital maintenance rules
Another type of liability may arise in connection with the capital maintenance rules. As a general rule, the company's equity may not be used to make payments to, or to give other benefits to, the company's shareholders; unless there is a shareholder resolution providing for such payment or benefit (such as the distribution of dividends or a share capital decrease). Also, in the case of group companies, the share capital of subsidiaries must not be repaid to the parent company (or paid to any other group company). However, cash pooling may (and in most cases is designed to) lead to situations in which the parent is benefiting from its direct subsidiary's contribution to the cash pool. Attention should therefore be paid to the capital maintenance rules when drawing up a cash pooling agreement.

Indeed, in the insolvency of a subsidiary, a receiver may ask the parent company to repay any amounts received from its subsidiary if there was not a shareholders' decision approving the payment or benefit that would otherwise be in breach of the capital maintenance rules.

c) Holding company liability
If a subsidiary's profit is frequently used for settling a holding company's debts, and the holding company does not provide the subsidiary with reasonable remuneration in consideration for that 'service' (by way of written agreement) by the end of the relevant business year, the holding company will be liable to the subsidiary for any consequences that the arrangement has had on it.

4. Mitigating the risk

a) General
The cash pooling agreement should be thoroughly considered by the directors before being entered into. If not, directors' liability may arise.

The cash pooling agreement should clearly identify and state the interest to be paid to the company contributing funds to the master account, as well as the interest paid by the company borrowing funds from the master account. As interest and reductions of cost are the main reason for entering into the cash pooling agreement, these should be particularly considered in case of any liability arising from the cash pool agreement.

b) Agreement between business enterprises (in Croatian "poduzetnički ugovor")
The Croatian Companies Act envisages a specific type of agreement between business enterprises (an "ABE")

whereby one company undertakes to transfer all or part of its profits to another company. Shareholders' meetings should approve an ABE with a qualified majority of votes. Therefore, when drafting a cash pooling agreement, provisions referring to ABEs should be considered.

5. Tax issues

If a company is "thinly capitalised" within the meaning of the law, i.e. to the extent that its borrowings exceed its registered share capital by more than four times, the company shall not be able to claim interest paid on the exceeding amount as an expense, and shall have to pay corporation tax on such interest. The affiliated company must, in any event, pay corporation tax (of 20%) on the amount of such received interest.

Furthermore, if interest is not given under the arm's length principle, it shall be considered as the paying of a 'hidden' dividend. In such instance, the company shall not be able to state such paid interest as an expense, and shall have to pay corporation tax on the interest instead.

Czech Republic

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Cash pooling is not directly regulated under the laws of the Czech Republic. Nevertheless, the generally accepted position is that cash pooling is an inter-group arrangement for the provision of financial accommodation and, as such, is regulated both by the companies act and by local banking and capital markets legislation. As such, the following company and banking law regulation will be relevant to cash pooling.

1. Company Legislation

a) Creditor protection
Creditor protection provisions in the Czech Commercial Code require that before a company takes a loan for which the aggregate consideration over the lifetime of the loan is greater than 1/10th of the company's registered capital, it must obtain a valuation by a court appointed expert prior to entry into the loan.

b) Thin capitalisation
Thin capitalisation rules mandate that any transaction resulting in a net liability to an entity, which is greater than 50% of its registered capital, must be approved by a general meeting of shareholders prior to being entered into.

c) Related party transactions
Related party provisions of the Czech Commercial Code will apply if participants in the cash pool share one or more common directors. In such a case, the law also requires general meeting approval to be obtained prior to entry into the arrangement and further requires that the arrangement be on arm's length terms.

2. Banking Legislation

a) Guarantees
In circumstances where cash pool members are required to guarantee the liabilities of every other participant in a cash pool then requirements exist mandating that each participant obtain either general shareholder meeting approval or an expert valuation of the cash pooling arrangement prior to entering into the guarantee.

b) Notification
Under the Czech Foreign Exchange Act there is an obligation to notify the Czech National Bank of entry into any cash pooling arrangement or of any amendment thereto. This obligation must be fulfilled within 15 days of such entry or amendment.

The same Act also imposes an obligation to notify the Czech National Bank of the entry into, or amendment to, the cash pooling arrangement by any foreign entity. This obligation is also required to be fulfilled within 15 days.

c) Anti money-laundering requirements
All entities, including participants in a cash pooling arrangement, which accept payments in excess of EUR 15,000 are required to record the identity of the counterparty and retain that information for a period of 10 years.

3. Liability

a) General
Breaches of corporate legislation may result in both criminal and civil liability for the officers of the relevant company and, in certain cases, the shareholders as well. In most

cases, such liability arises from the commission of a "crime" against the property or other economic interest of a company by the officers of that company, and is not specific to cash pooling transactions. Breaches of relevant banking legislation carry liabilities in the form of fines for the companies who breach them.

b) Affiliated parties liability
In the case of affiliated entities, a special category of liability exists for a controlling entity to compensate damages caused by measures or agreements harmful to any controlled entity. Directors, and in certain cases shareholders, of the controlling entity may be held jointly and severally liable for such damages if found to have acted dishonestly or for an improper purpose in directing or otherwise influencing the controlled entity to enter into such agreements.

4. Risk mitigation steps

The following actions are recommended to be taken in respect of all Czech entities intending to participate in a cash pooling arrangement.

— Approval of the general meeting of shareholders should be obtained for each entity's entry into the cash pooling arrangement. If approval is obtained for the general framework within which the individual loans will be made then only one general shareholder meeting will be needed to approve all the as yet undocumented loans to be made.

— Articles of association of each Czech entity who will be a party to the arrangements should be reviewed, to ensure compliance with any additional requirements contained therein concerning any restrictions on indebtedness of the entity or on the types of agreements the entity is permitted to enter into, as well as any special conditions which may need to be fulfilled prior to entry into a cash pooling arrangement.

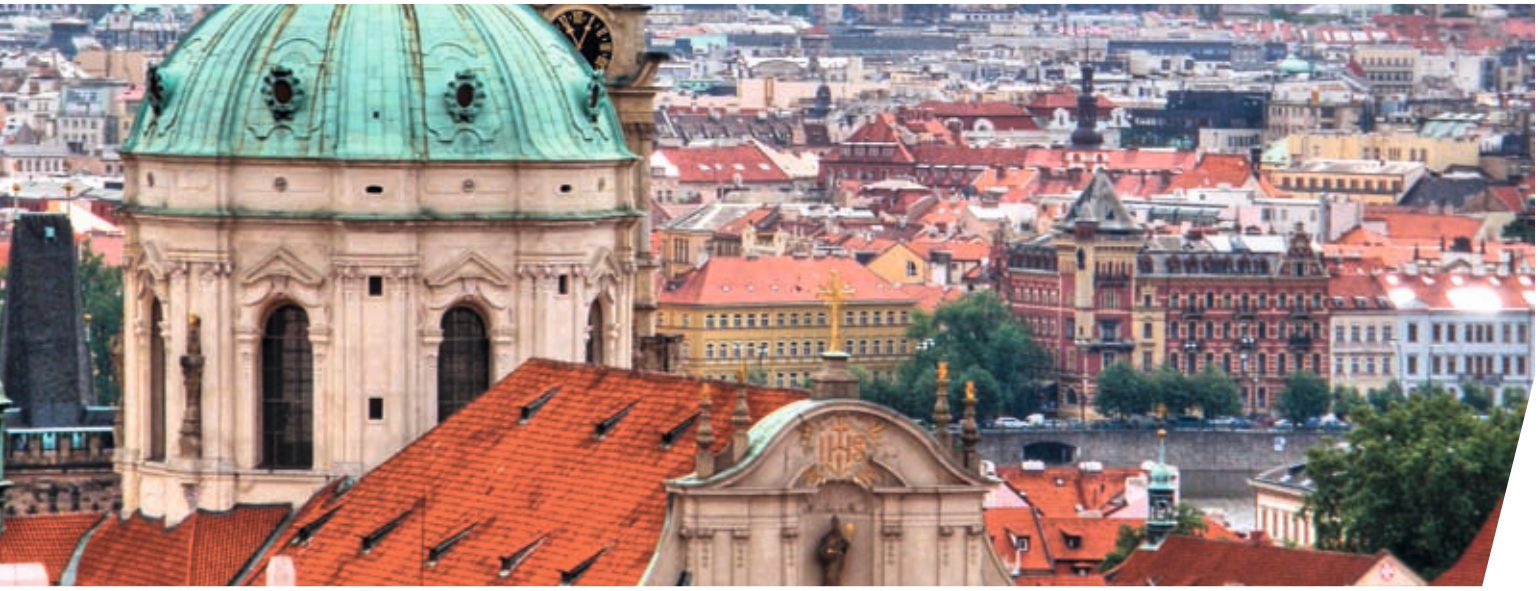
— Obtaining an expert valuation of the cash pooling arrangements by a court appointed expert to evidence arms' length terms of the transaction. This can be done by petitioning a Czech court to appoint and approve a registered expert to produce a valuation of the cash pooling arrangement for each Czech entity that intends to participate.

— Ensuring each entity complies with its filing obligations to the Czech National Bank by notifying it of the form, content and general conditions of the credit agreements to be used in the cash pooling arrangement, and of the nature of any local or foreign bank accounts to be used. This notification obligation should be fulfilled within 15 days of the date of the first payment under the arrangement taking place.

5. Tax considerations

a) Interest deductibility
Under Czech income tax legislation, all expenses incurred for the purpose of generating, assuring or maintaining taxable income of a company are deductible. This includes interest expenses on loans under a cash pooling arrangement. However, if thin capitalisation rules are breached then any interest expenses claimed as a deduction are void and the tax liability is reinstated.

Generally, the parties are free to determine a rate of interest that will be charged on loans under the cash pooling arrangement, but regard should be had to the thin capitalisation and related parties' transactions legislation described above when deciding on what rate of interest should be charged. Specifically, the requirement for the transaction to be at arm's length will necessitate the provision of such loans at commercial rates of interest prevailing in the loans market for unaffiliated parties. If this is not ensured, the Czech Tax Authority may order that an adjustment be made to the taxable income of any entity under such an arrangement. These adjustments take the



form of either a partial exclusion from the tax deductibility of a borrower entity's interest expenses, or an increase in the tax base of any lender entity held to be charging interest at a rate considered too low.

In circumstances where it is difficult or impossible to objectively assess whether particular terms of an arrangement comply with the arm's length requirement, regard may be had to the OECD's transfer pricing guidelines. The guidelines provide a useful framework for settling price valuations by explaining in considerable detail how to apply the arm's length principle. Generally, the relevant taxpayer is only required to show that the valuation method used delivered a reasonable "arm's length" result and is not obliged to justify its selection.

It is also possible to obtain a binding assessment of the Czech Tax Authority, confirming the chosen rate of interest satisfies the arm's length requirement. This, however, must be done prior to the entry into the cash pooling arrangement, as the Authority will not issue any retrospective assessment.

b) Withholding tax

Generally, interest and other consideration relating to loans, deposits and securities paid to entities outside the Czech Republic are subject to withholding tax at a rate of 15%.

Outbound interest payments are exempt from income tax (withholding tax) provided that:

— the beneficial owner of the interest is a company related to the paying company;

— it is residing in another EU Member State; and

— a statement of exemption has been issued by the Czech Tax Authority.

The Czech tax authority will only issue a statement of exemption if it receives the following documentary evidence along with the application:

— notification of a relevant EU Tax Authority that the foreign company is tax resident in that country;

— evidence that the foreign entity has an acceptable legal form under EC regulations;

— evidence that the participating companies are related parties;

— a description of the methodology used to set the rate of interest on loans under the cash pooling arrangement; and

— evidence that the recipient of the interest is the ultimate beneficial owner of it.

Hungary

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1. Legal issues

a) Legal framework for cash pooling
There is no specific law or regulation in Hungary that contains detailed rules on cash pooling. Nevertheless, a decree of the National Bank of Hungary does differentiate, and thereby accepts, the two concepts of cash pooling noted in the introduction of this brochure; "physical" cash pooling and "virtual" (or "notional") cash pooling.

In addition, whilst Hungarian banking legislation requires those participating in commercial lending to seek the authorisation of the Hungarian financial services authority (the "PSZÁF"), there is an exception that financial transactions between a parent company and its subsidiary, or between subsidiaries, that are carried out jointly in order to ensure liquidity do not require authorisation – provided that the companies are not classified as financial institutions. Group companies should therefore be able to pursue an active cash pooling arrangement in Hungary without the need for PSZAF authorisation.

b) Hungarian company law: the maintenance of share capital
Pursuant to Hungarian company law, a Hungarian company's equity must exceed the minimum level of registered share capital required for a company of its form, as set by statute. If it does not meet this requirement in two consecutive years, known as a situation of "negative-equity", then the shareholders should provide enough equity to ensure that it does (and within a certain deadline). Alternatively, the company should decide on its transformation into another form of company, or on its termination without legal successor.

This clearly has consequences for cash pooling arrangements. Directors should be careful to ensure that the company's contributions to the cash pool do not cause the company to enter into "negative equity", particularly if the contributions may not be recoverable (e.g. due to the insolvency of another cash pool participant).

In addition, directors have a duty to call an extraordinary general meeting in situations where the share capital of the company is threatened. An example is where the equity of a Kft (limited liability company) has fallen to below half of the amount of its registered share capital (due to losses). The subsequent members' meeting must take rectification measures (e.g. make additional capital payments or decrease the registered capital). Parent companies should therefore be concerned that the cash pooling arrangement does not result in subsidiaries overextending their contributions at the expense of the equity on their balance sheets.

Hungarian law also strictly stipulates when shareholders of a company can receive payments (i.e. dividends) from the company. Withdrawals from the cash pool account by the parent company, and payment into it by the subsidiary, should therefore not infringe these rules – or else there is a risk of invalid distribution.

c) Liability
As a general rule, the directorsof a company involved in cash pooling are to ensure that the company does not fall into insolvency by reason of the arrangement. The shareholders will also want to avoid a situation of "negative equity", as described above.

In addition, the shareholders and directors should be aware of the following:

(1) Piercing of the corporate veil

If a limited liability company or company limited by shares is terminated without legal successor, a shareholder cannot rely on its limited liability if it has misused such protection, and the same applies if a shareholder holding at least 75% of the voting rights conducts, as shareholder, a business policy permanently disadvantageous to the company. Therefore, it is possible that the shareholders of a company have joint, several and unlimited liability for the unsatisfied debts of their company. This mainly arises if the

shareholders do not take any of the actions required by law to resolve an unlawful situation, such as a "negative equity" situation, or if they have disposed of assets in a way that they knew or should have known would result in the company being unable to pay its debts when due. In a cash pooling arrangement, such a situation may arise if, for example, the parent company withdraws contributions of a subsidiary, leaving it without liquidity and forcing it into insolvency.

(2) Directors' liability for damages

Under Hungarian company law, directors of a company are liable to the company for damages it suffers as a result of the directors' failure to comply with relevant laws, the constitutional requirements of the company, the resolutions of the shareholders and their executive duties. The damages that a company may suffer includes that suffered directly by the company, or, damages caused by the director to third parties (e.g. creditors) where such third parties have received compensation from the company.

The directors of a company should therefore be careful to ensure that, amongst other things, in setting-up and operating the cash pooling account they have the necessary capacity under the company's constitution to do so – and seek shareholders consent if not. They should also ensure that the risks posed to a company by a cash pooling arrangement, such as the loss of liquidity if another participant becomes insolvent, do not jeopardise the company so as to put them in breach of their duties.

However, a director will not be liable to the company if he can prove that he acted as was expected of him under the relevant circumstances - he being obliged to act with the care expected of a person holding such office, making the interests of the company a priority (subject to the exception below).

(3) Director's liability for debts

If a situation occurs that threatens the solvency of a company, the directors have to perform their obligations giving priority to the interests of the creditors of the company (and not to the interests of the company or the members). If this obligation is breached and the company enters into liquidation, a director may be held to have unlimited liability for the unsatisfied debts of the company; unless he can prove that following the threat of insolvency he took all measures that could be expected of him in such a situation to reduce the loss suffered by the creditors. The same liability rule applies to any person having a de facto decisive influence on the decision-making of the company (which can include the parent company).

In light of this, directors who are aware that another participant in the cash pool is having solvency problems, putting the cash pool at risk, may wish to withdraw the company from the arrangement, so as to prevent and minimise any potential loss to the company's creditors. In addition, it would be sensible for the directors of group companies involved in cash pooling to have a right of information as to the solvency of the other group companies, so as to spot any early warning signs.

2. Tax issues

a) Thin capitalisation rules

If the total debts of a Hungarian company are greater than three times its equity, the interest charged (and deducted as an expense for accounting purposes) on the excess debt will not be deductible for corporation tax purposes.

The debt applicable for this purpose includes, amongst other things, any debt under a cash pooling scheme.

b) Interest deductibility
The tax-deductibility of interest paid in respect of money withdrawn from the cash pool should be recognised by the Hungarian tax authority, so long as the loan serves the business purposes of the taxpayer.

c) Corporation tax
Any income earned from interest earned in a cash pool forms part of the general accounting pre-tax profits of a company, and is taxed at the rate of 19%.

As of 2010 a new, favourable tax regime for foreign sourced interest income was introduced. Accordingly, 75% of the (net) interest income received from abroad is to be excluded from the corporate tax base. Technically, this can result in an effective tax rate of only 4.75% on the foreign-sourced interest income. Thus, interest paid into the pool by non-Hungarian participants and withdrawn by Hungarian participants may be subject to this preferential tax treatment.

d) Withholding tax
As a general rule, Hungarian sourced interest payments, to non-Hungarian companies resident in a country with which Hungary has concluded a double tax treaty, are not subject to Hungarian withholding tax. However, if there is no double tax treaty in place, a tax rate of 30% on interest payments will apply. Participants in the cash pool outside of Hungary should therefore be aware of this possibility.

e) Transfer pricing rules
If the pool members are considered related parties for corporation tax purposes, the following transfer pricing requirements are to be observed by the Hungarian pool members:

— to apply arm's length prices or to adjust the corporation tax base to reflect the situation where market prices and market conditions have been applied (i.e. interest at a market rate should be charged on any cash pool borrowing);

— to notify the Hungarian tax authorities of related party transactions within 15 days of entering into a contractual arrangement for the first time; and

— to maintain sufficient documentation of the related party transactions.

Besides the notification requirement, the requirement to maintain documentation should especially be observed; it is recommended that the cash pooling arrangement is suitably evidenced in documentary form.

f) VAT rules
To comply with the implementation requirements in relation to the new EU VAT package, the Hungarian VAT Act was significantly amended in 2010. Accordingly, a new general rule is applicable to services supplied to businesses pursuant to which the place of supply will be the place where the customer is established.

Furthermore, financial services (such as lending) are exempt from VAT. It therefore needs to be considered whether the cash pooling services provided will be subject to this exemption and, if not, where the place of supply is. It is recommended that one clarify this issue with a Hungarian tax professional, prior to the setting up of a cash pooling structure.

Poland

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In Poland there are no specific rules governing cash pooling agreements. However, the risk connected with these kinds of arrangements has considerably increased in recent years, mainly as a result of a lack of regulation in Poland and the frequency of cash pooling transactions within groups of companies in Europe. Therefore, there are some risks (including corporate risks, liability of directors and tax risks) that, as described below, must be taken into account in carefully structuring the transaction.

1. General legal framework

Cash pooling enables a group of companies to benefit from their surplus cash by transferring it to a bank account and using the funds when necessary. However, under Polish law there are no guidelines for managers on balancing the interests of the individual company with the interests of the entire group, and it is not an option to subordinate the management board of one company to the interests of a dominant company or group of companies.

Nevertheless, in practice it is still possible to undertake activities that are objectively contrary to the interest of a company, but at the same time profitable for the company's shareholders or capital group of companies, so long as the rules considered below, amongst others, are respected.

a) Insolvency issues and capital maintenance
A general risk of participating in cash pooling is that a company may become insolvent if the monies transferred to the master account are not invested properly or are not transferred back to the company. This may especially be true if the insolvency of one of the participants has an adverse effect on the functioning of the other participants (for example, it may be that the insolvent company had been providing liquidity to the other participants).
The other key risks surrounding insolvency are that:

— The creditors of an insolvent participant propose a motion to declare the company's insolvency. Although such a declaration does not, generally speaking, cause the termination of a cash pooling agreement, the insolvency trustee may go on to terminate the agreement.

— If a company within a cash pooling arrangement acts to the detriment of its creditors, by distributing cash to other cash pool participants instead of its creditors, and there is a material benefit to the other participants, then the creditors may demand that such actions are declared ineffective.

— If a company declares insolvency within two years of a loan being granted by a shareholder to the company, the loan may be regarded as a capital contribution to the company by the shareholder. Therefore, in a cash pooling structure, any transfer of funds by a parent company to the master account may be risky if the subsidiary removes the parent's funds and later (within two years) the subsidiary becomes insolvent.

In the event of insolvency (including when the balance sheet shows a loss exceeding the aggregated supplementary and reserve capitals, and half of the share capital), the management board must immediately convene a shareholders' meeting in order to decide on the future existence of the company.

It should also be noted that a cash pooling arrangement may cause a violation of Polish capital maintenance rules. For example, this may arise if participants contribute funds to the cash pool account with the effect that the assets of the company fall below what is required to maintain the company's share capital.

b) Unlawful distributions
The Polish Commercial Companies Code provides that a company is prohibited from:

— returning any capital contributions made by the shareholders (except when it distributes profits); or

— returning any payments from a company's assets to the shareholders (this includes loans, as the payment may be understood not only as a decrease of the assets but also as an increase of liabilities).

In addition, the prohibition includes third parties who do not have the status of a shareholder but who are closely connected to shareholders (personally or economically) – such as other companies that are owned by a shareholder.

Consequently, shareholders are only to receive a return of their contributions, or the assets of the company, after liquidation of the company (if such an event occurs). Cash pool participants should therefore be sure that payments into the account by a subsidiary, and subsequent withdrawals by its parent company, should not breach these rules.

2. Liability

If capital maintenance rules are breached there is a high risk that the directors of the company will be held liable for a civil or criminal offence. The risk of civil or criminal liability is more significant if a company becomes insolvent.

a) Liability of directors
— In principle, the directors of a company are responsible for the financial safety of the company. This means that they are obliged to act with the due diligence of someone of their professional character and activity, and to avoid any situations that may lead to the company's insolvency. Therefore, their actions should be compliant with statutory laws and the provisions of the company's articles of association. The directors of a company that proposes to enter into a cash pooling arrangement will therefore need to evaluate the risk of damage to the company against any benefit it may accrue; a failure to make such proper consideration may put the directors in breach of their duties.

— An example of where liability may arise is when a company has become insolvent as a consequence of a transfer of funds to the cash pool, such funds being swallowed as a result of, for example, another participant's insolvency. In such instance, the members of the management board may be held personally liable if they fell short of the duty upon them to ensure repayment of the funds.

— In addition, management board members are, in certain situations, jointly and personally responsible with a company for its liabilities.

There are no exemptions from the above liabilities; in particular, the board may not seek to rely on a resolution of a shareholders' meeting granting directors discharge from their duties, or claim that the company waived any claims in respect of the activities undertaken by the board.

b) Liability of a parent company
The general rule is that the shareholders of capital companies are not responsible for a company's debts; their liability is limited only to the value of the contribution they made to the company's share capital.

3. Banking law and foreign exchange regulations

Cash pooling is not regulated under Polish banking law, so the parties to a cash pooling arrangement must devise a legal structure for such arrangement based on conventional legal instruments and concepts (such as inter-company loans or subrogation), or on the principle of freedom of contracting.

Creating and entering into a cash pooling arrangement does not require a bank licence and is not a regulated activity. However, the participation of a Polish entity in a multi-jurisdictional cash pooling arrangement may be subject to restrictions imposed by Polish foreign exchange regulations, especially when it involves entities from non-EU/EEA jurisdictions. Additionally, Polish foreign exchange regulations impose certain reporting obligations on residents that enter into financial arrangements with non-residents (including non-residents from within the EU/EEA). Depending on the volume of a given resident's foreign operations, reports to the National Bank of Poland may have to be submitted on a monthly or quarterly basis (residents with low volumes of foreign operations are exempt from those reporting obligations altogether).

4. Tax issues

Cash pooling arrangements are not specifically regulated under Polish tax law. The most sensitive tax areas related to cash pooling are the following:

— Civil Law Agreements Tax ("CLAT"). As a rule, loan agreements are subject to 2% CLAT. According to the majority of binding rulings, cash pooling agreements should not be viewed as loans and therefore CLAT should not apply. However, Polish law provides for a severe sanction for the non-payment of CLAT on loan agreements: 20% of the principal amount. Therefore, to avoid a dispute with the tax authorities, applying for an individual ruling is always recommended.

— Withholding tax. Interest paid abroad is subject to 20% withholding tax. Therefore, interest paid by a Polish entity into a foreign cash pool will be subject to withholding tax. The tax can be reduced (even to zero) by the relevant tax treaties. Many of them provide for a zero withholding tax rate on interest paid to banks, provided that the bank is a beneficial owner of the interest.

  However, the tax authorities tend to challenge the beneficial nature of the bank's ownership of received interest (although, in some cases this approach has been rejected by the courts). Therefore, to make sure that interest paid by a Polish entity will not be subject to withholding tax, a binding ruling will be required.

  Another basis for exemption could be the parent-subsidiary directive. However, the directive will not be fully implemented into Polish law until 2013.

— Thin capitalisation. Interest paid to: (1) a parent company owning at least 25% of the shares of the borrower; or, (2) a sister company, where a common shareholder owns at least 25% of the shares in both companies, ("qualifying lenders"), are subject to thin capitalisation rules. Under those rules interest paid on part of a loan granted by qualifying lenders, which exceeds 3 times the share capital of the borrower, does not constitute a tax-deductible cost.

Romania

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Cash pooling is not a widely used financing method in Romania. Indeed, with the legal background fragmented, it appears that there are limited Romanian banks currently offering cash pooling arrangements. Nevertheless, cash pooling is likely to be utilised more in the future, given the benefits it can generate. As such, cash pooling arrangements must be carefully structured in order to respect the relevant Romanian law, and minimise liability risks that may affect participating companies at both shareholder and director level.

1. Legal framework for cash pooling

Although the concept of cash pooling is not specifically regulated under Romanian law, it is clear that there are certain provisions that will impact on any arrangement.

a) Banking regulation

(1) Restrictions on lending

As noted in the introduction to this brochure, the submission of a group company's excess cash to a cash pool account, to be withdrawn by other group companies, could amount to an inter-group loan. However, pursuant to Romanian banking law the granting of loans on a professional basis can only be performed by credit institutions or non-banking financial institutions. A breach of this rule can result in various sanctions, including (but not limited to) fines for the company, and up to 3 years imprisonment for the directors – and even the potential of corporate criminal liability.

However, the long-standing position is that intra-group loans are not considered to be a professional lending activity, even though there is nothing specific in the law to state that. Nevertheless, it must still be noted that any business model involving the performance of activities similar to credit institutions or non-banking financial institutions is subject to the assessment and control of the National Bank of Romania ("NBR"). The NBR is therefore ultimately vested with the power to determine whether or not an activity, such as cash pooling, is a lending activity performed on a professional basis.

(2) Statistical reporting to the NBR

If a group cash pooling arrangement involves the participation of both Romanian and foreign companies, certain statistical reporting requirements of the NBR may need to be observed. One such example is that resident companies that have signed contracts with non-resident companies for foreign currency arrangements, in the form of medium and long term private debt (e.g. inter-group cash pool lending, for a period exceeding 1 year), must notify the NBR's statistics department of such arrangements within 30 days of the date of signing.

In addition, any payments to, or collections from outside of, Romania that are equal to or in excess of EUR 12,500, as at the payment/collection date, and which are made or received by Romanian companies to/from non-resident companies, have to be reported to the NBR (for the purpose of drawing out Romania's balance of payments). Such a reporting requirement will clearly impact on cross-border cash pooling arrangements.

b) Corporate law

(1) Significance of corporate law in the context of cash pooling

When setting up a cash-pooling arrangement, consideration must be given to the overarching principle of "corporate benefit"; that any activity performed by the company must be in the company's commercial interest. There may be many reasons why a company can draw benefit from a cash pooling arrangement, and the directors should ensure that these clearly outweigh any disadvantages, to ensure that the activity is of corporate benefit. At a practical level, the directors may wish to document these reasons in the minutes of their board meetings.

Building on this, it must also be borne in mind that a company can only perform those activities specifically included within its official scope of business, as stipulated by its charter. Agreements that do not observe this requirement may be void and may give rise to liability for the company (typically in the form of fines and/or sanctions for the company's directors).

(2) Capital maintenance rules

The registered share capital of Romanian companies must meet the minimum amount required under Romanian law. If the board of directors become aware that the equity of the company amounts to less than half of the required minimum, due to losses, (a situation of "negative equity") they must call an extraordinary general meeting of the shareholders without delay. The extraordinary general meeting must then resolve to dissolve the company, unless rectification measures are approved (such as making additional capital payments or decreasing the registered share capital). Directors should therefore be careful to ensure that the company's contributions to the cash pool do not cause it to enter in to a "negative equity" situation, particularly if the contributions may not be recoverable (e.g. due to the insolvency of another cash pool participant). In addition, Romanian company law strictly stipulates when the shareholders of a company are entitled to receive payments (i.e. dividends) from the company. Withdrawals from the cash pool account by the parent company, and payment into it by the subsidiary, should therefore not infringe the relevant rules – or else there is a risk of invalid distribution.

(3) Rules restricting a company's indebtedness

As a general rule, the shareholders and directors of a company must ensure that a company does not become insolvent. If they fail in this, and the company becomes insolvent, they risk transactions concluded within the 3 years prior to the insolvency being annulled if they were detrimental to the creditors. An example is where a parent company requires its subsidiary to make a contribution to the cash pool prior to insolvency, so that the parent company can withdraw such funds to the disadvantage of the subsidiary's creditors. If such a transaction is annulled, the parent would have to pay back a sum representing the withdrawal.

(4) Authorisation procedures

Normally, the setting up of a cash pooling arrangement should be approved by at least the boards of directors of the participating companies. Moreover, in order to avoid any potential liability of the directors, and to ensure that the shareholders are aware of the pool's operation, it is advisable that the general meeting of the shareholders authorise the directors to carry out the cash pooling arrangement by means of a resolution of the general meeting.

In any event, the charter of the company should always be checked for the specific authorisation procedures of the company.

2. Liability risks

a) Liability of the shareholders
The general rule under Romanian company law is that the shareholders and the company are independent entities. Shareholders are only liable for the company's obligations up to the amount of their subscribed and paid-up share capital (limited liability). However, there are certain exceptions to this rule, which in general mean that if the creditors can prove that the shareholders abused their limited liability, by reason of a fraudulent act contrary to the creditors' interests, the liability of the respective shareholders becomes unlimited.

In light of this, if a participant to a cash-pool starts to show liquidity problems, and it has contributions sitting in the pool account, the parent company would be unwise to make a withdrawal of that money for the purpose of protecting its own position.

b) Liability of the directors or managers
As a director's obligations are defined in his service/mandate/labour agreement and the law, the liability of a director can be both civil and criminal. A director's breach of his service/mandate/labour agreement may result in contractual (civil) liability to the company; where as a violation of law may result in tortuous (civil) or criminal liability.

(1) Criminal liability

Generally speaking, a director of a company may be imprisoned for up to 3 years if, in bad faith, he uses the assets of the company for a purpose contrary to the company's interest, or in favour of another company in which he has a direct or indirect interest. Directors of more than one company in a cash pool account should therefore be careful not to cause one company to make contributions to the cash pool that are only for the benefit of the other company.

However, Romanian company law has been amended recently to permit and encourage treasury operations within groups of companies, suggesting that the interest of the cash pool group should prevail over the individual interest of each company participating. It therefore appears that, to the extent an inter-group loan is granted in good faith, without the intent of creating a negative impact on the financial situation of the lending company, the director would not have committed a criminal offence.

In addition, any inter-group borrowing must not prejudice the interests of minority shareholders and creditors – if it does, the director risks criminal liability. To prevent this, the borrowing must be concluded on an arm's length basis (i.e. subject to standard market conditions) without causing the lending company any insolvency issues.

(2) Civil liability

In addition to being liable to the company for any breach of his service/mandate/labour agreement, a director's liability may extend to third parties, such as creditors of the company (in an insolvency) or third parties who incurred a loss as a result of the actions taken by the director that were beyond the scope of his powers. It is therefore important that directors implement cash pooling arrangements within the main legal structure noted above – for example, with the need for corporate benefit; protecting share capital; respect for the company's charter; and, adherence to the relevant authorisation procedures. There are also numerous other offences relevant to cash pooling that a director should be aware of, including: (i) providing false information to a parent company; (ii) paying or receiving dividends resulting from false profits or profits which cannot be distributed; (iii) fraudulent management; and (iv) possession of cash without registering it in the accounting books.

3. Legal structure and reduction of risks

a) Formalisation of the cash pooling arrangement in a written agreement

In order to reduce the risk of liability associated with a cash pooling arrangement, it is recommended that the arrangement be set out in a written agreement. In the absence of a written document, it may be difficult to provide evidence of the rights and obligations of the participating companies. Moreover, the written form is necessary for fiscal purposes – in order to allow deductibility of interest and net losses resulting from currency rate variations.

b) Precautions to be taken in relation to written agreements

(1) Right to information

Once the cash pooling system has been introduced, it is necessary to constantly monitor the credit status of the participants. If a group company suffers a liquidity crisis and fails to withdraw from the cash pool in sufficient time, it could endanger the liquidity of the entire group. This is why the companies participating in a cash pooling arrangement should be continuously updated about the financial situation, especially regarding the liquidity of the parent/treasury company and of the group in general.

(2) Right to terminate the cash pooling arrangement

The cash pooling agreement should include provisions that allow participating companies to withdraw from the agreement, if participation in the cash pool is no longer in the company's interest.

c) Guarantees to be granted

To the extent that the cash pooling structure involves the provision, by a bank, of group-wide credit facilities, the group companies involved may be required to provide guarantees to the bank in respect of each other. However, as there is a need to show corporate benefit to the guarantor, it is advisable that a fee is paid to the guarantor (from the guaranteed) in consideration of giving the guarantee. Although, giving such a guarantee in exchange for consideration may be outside the scope of the guaranteed's objects and may therefore be ultra vires. It is important that the company's charter is checked in this respect.

4. Tax issues

The concept of cash-pooling is not specifically defined in Romania's tax laws and there is uncertainty as to the provisions relevant to cash pooling arrangements. As such, it is advisable that a company considering a cash pooling arrangement approach the Romanian tax authorities and consult a professional tax advisor as to their interpretation of the law.

a) Interest deductibility and thin capitalisation rules

The interest deductibility rules are clearly relevant to cash pooling. As such, the cash pooling agreement should be drafted carefully, in order to be clear whom is paying the interest – and whom can therefore take advantage of the rules. In addition, if the interest deductibility rules are to apply, the "thin capitalisation rules" should also be observed. Pursuant to these rules, interest deductibility is only allowed where the debt to equity ratio of the Romanian borrower does not exceed 3:1 and/or the equity is not in negative territory.

b) Transfer pricing rules
The necessary transfer pricing rules should be observed when establishing the interest rates to be charged on inter-group lending through a cash pool arrangement. Pursuant to the transfer pricing rules, transactions between affiliated parties must be made on an arm's length (i.e. market) basis. If this requirement is not observed, the Romanian fiscal authorities may adjust the interest rates used, so as to reflect the market value of the services that were provided.

c) Withholding tax
When the Romanian beneficiary of cash pool liquidities pays interest on those liquidities to a company located outside of Romania, withholding tax will be levied unless a tax treaty applies which enables tax to be withheld or reduced.

In determining whether the interest is being paid to a foreign company, it is necessary to clarify the identity of the beneficiary of the paid interest. As this can be difficult to do, it is possible to conclude that the actual beneficiary is likely to be the parent company. And although Romanian law does not make any provision in this regard, this is likely to be presumed unless proved otherwise.

It also remains to be seen whether, in some circumstances, and upon the fulfilment of certain terms (for example, cash-pooling where there are no loans between the companies involved), tax authorities would assimilate such cash pooling accounts to on-sight deposits or current accounts. In such instances, interest obtained by non-residents from Romanian legal persons would not be subject to withholding tax.

Russia

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In Russia cash pooling is a relatively new concept, becoming commonplace only within recent years. There is no unified legislation governing cash pooling arrangements and the legal framework in which cash pooling operates consists of specific company law provisions on capital maintenance, financial assistance and inter-company loans, as well as banking and tax law regulations.

1. Legal framework for cash pooling

Russian legislation regulating cash pooling and cash management arrangements is based, amongst other things, on the general provisions of the Civil Code of the Russian Federation (the "Civil Code"), specific provisions of the Tax Code of the Russian Federation (the "Tax Code"), the federal law on insolvency/bankruptcy (the "Bankruptcy Law") and the federal law "On Banks and Banking Activity"; as well as various other instructions and regulations of the Central Bank of the Russian Federation (the "Central Bank").

2. Form of agreement for cash pooling

Russian banks provide their clients with "physical" and "notional" cash pooling services. However, in practice, Russian banks have a preference for physical cash pooling based on inter-group loans. The cash pooling structure that has been developed and is generally used by the Russian banks stipulates the following requirements and is operated under the following terms and conditions:

— The master account, together with the accounts of the group members, should be opened and maintained in a single bank. In practice, the master account is normally opened by the parent company.

— Each group company enters into an inter-group loan agreement with the parent company. Such inter-group loan agreement stipulates the possibility of loans being provided by the parent company to a subsidiary and vice versa.

— It should be noted that if one of the group companies is non-resident, the currency control rules apply. Accordingly, the bank should open a deal passport if the general amount of the potential loan between the Russian company and non-resident company exceeds USD 5,000.

— The inter-group loans should be provided on an arm's length basis, i.e. interest is to be paid at the market rate. It is sufficient that the inter-group loan agreement contains the interest provision and the loan repayment date.

— The parent company should enter into a master loan agreement with the bank. Under the terms of such master loan agreement the bank shall, amongst other things, make a facility available to the parent company, including overdraft provisions.

— Such agreements are usually long term facilities with the maximum loan/overdraft amount available. This enables the bank to fall within the "reservation" requirements on covering potential losses that may occur in case of a default on repayment of the loan.

— Russian banks usually require a guarantee or other form of security from the parent company, in order to secure repayment under the master loan agreement.

3. Liability

a) Liability of the parent company
Under the Civil Code provisions, a company will be recognised as a parent company of a subsidiary if: (i) it owns a majority of the registered share capital of the subsidiary; or, (ii) under an agreement entered into by the "parent" company and such "subsidiary", or in any other way, the "parent" company can substantially influence the decisions made by the "subsidiary".

The parent company can become liable for the debts of its subsidiary in an insolvency situation (i.e. when its assets will not satisfy its obligations) if the insolvency has been caused by the parent company. The same liability may arise for any other person that influences the activities or decision-making of the subsidiary.

b) Liability of the executive and supervisory bodies
Under the federal laws "On Limited Liability Companies" and "On Joint Stock Companies", the members of the board of directors, the general director and the members of the executive body of the company must act reasonably and in the company's interests. Should they fail to do so, and their inappropriate actions or omissions cause loss to the company, then they may be liable for such loss (unless otherwise stipulated in Russian legislation).

Like the parent company (see above) the members of the executive and supervisory bodies, and other persons authorised to control the activities of the company, may also be liable for the losses of an insolvent company if such insolvency was caused by their actions (e.g. making a decision to use cash pooling services) or if it were caused by their omission to act, provided that they were aware that their actions could lead to the insolvency of the company. If several persons are liable, they will be considered as jointly liable. The members of the supervisory and executive bodies may also bear administrative and criminal liability for the losses they have caused to a company (particularly in the event of deliberate or fictitious insolvency and unlawful actions in case of insolvency).

An example of how liability could arise in a cash pooling arrangement is where a director, on realising that another participating group company has solvency issues, fails to take appropriate measures to reduce the exposure of his company to that potentially insolvent participant, such as withdrawing his company from the cash pooling arrangement (if this is possible under the terms of the agreement). Failure to take such necessary action may result in liability for the director.

c) Liability of banks
In addition to the liability risks facing companies participating in cash pooling, the banks too should be aware that their activities, including the provision of cash pooling services, are monitored by the Central Bank. If the cash pooling product or service breaches any provision of a federal law or any instruction of the Central Bank, the latter may fine the relevant bank up to 0.1% of the bank's registered capital, or restrict it from carrying out any banking activities for a term of up to six months. If the bank still does not conform to the relevant law, the Central Bank will be entitled to revoke the bank's license.

4. Measures to reduce the risk

a) Objects of the company
The articles of association should include the objects of the company. The authority of the company's executive body (CEO), management and board of directors is limited by such objects, i.e. the board of directors may only pursue activities that fall within the scope of the company's objects. If the board makes a decision to take any action that is beyond the scope of the company's objects, the

directors may be held liable to the company and to third parties. The same applies to the other executive bodies of the company.

In order to participate in cash pooling, it is therefore necessary that the objects clause of a company allows it to lend to and borrow from other companies, and grant guarantees.

b) Right to terminate the cash pooling arrangement
Companies participating in a cash pooling arrangement should reserve the right to immediately terminate the cash pooling arrangement in respect of themselves and to be repaid funds they have contributed to the cash pool – even at very short notice – if the repayment of such contributions is endangered by the financial situation of other participants. It should also be expressly written that any existing (or future) obligation including payments from and to the participating companies can be set off against each other.

5. Tax issues

The deductibility of interest for corporate income tax purposes (including that paid pursuant to a cash pooling arrangement) is allowed by the Russian tax authorities within a certain limit – the refinancing rate of the Central Bank multiplied by the coefficient 1.1 for loans in Rubles, and 15% for loans in a foreign currency.

In addition, deductibility of interest can be limited by the application of the "thin capitalisation" rules, which are designed to restrict the erosion of the Russian borrower's income tax base through the payment of excessive rates of interest on its loan obligations.

Serbia

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1. Legal framework

a) Introduction
In Serbia there is no specific legislation on cash pooling. Cash pooling arrangements should therefore comply with general corporate and banking regulations.

Cash pooling is not a widely used financing method in Serbia. There are only a limited number of Serbian banks offering notional cash pooling arrangements.
The restrictions that apply to cash pooling refer to cross-border cash pooling. Serbian entities are generally allowed to have bank accounts with banks registered in Serbia, but opening an account with a foreign bank (meaning a bank with its seat outside of Serbia) requires prior approval of the National Bank of Serbia ("NBS"). In addition, foreign exchange regulations allow Serbian entities to grant a loan to a foreign entity only if the loan is granted from the profits of the Serbian entity that have been realised abroad, and, if the foreign borrower is a majority-owned subsidiary of the Serbian entity. Therefore, cash pooling that would include entities with seats both inside and outside of Serbia, and/or a foreign bank, may not be feasible.

b) Banking legislation
Pursuant to Serbian banking law, the granting of loans on a professional basis can only be performed by banking financial institutions. A breach of this rule can result in various sanctions, including (but not limited to) fines for the company, and up to 10 years imprisonment for the directors – and even potential corporate criminal liability.

However, the long-standing position is that intra-group loans are not considered to be a professional lending activity, even though there is no explicit provision in the law to that effect. Nevertheless, it must still be noted that any business model involving the performance of activities similar to those of banking financial institutions is subject to the assessment and control of the NBS. The NBS is ultimately vested with powers to determine whether or not an activity, such as cash pooling, is a lending activity that is performed on a professional basis.

c) Company legislation

(1) Duty of care/conflict of interest

Majority shareholders of the company, the managing board and any persons engaged in the management of the company owe a general duty of care and loyalty to the company and are subject to a corresponding liability for breach of these duties. The majority shareholders and directors are primarily required to perform their duty in good faith, with the care of a prudent businessman, and in a reasonable belief that they are acting in the company's best interests. Failure to comply with these duties can lead to personal liability to the company.

Generally speaking, the primary obligation of the majority shareholders and of the company's duly diligent director is to prevent the company from falling into insolvency. Consequently, the concern of the majority shareholders and director is that an inherent risk in cash pooling is the insolvency of one participant threatening the solvency of all the participants. In addition, certain transactions undertaken by a company 3 years prior to the commencement of insolvency proceedings may be challenged if they were detrimental to creditors. For example, this may be the case when a parent company requires its subsidiary to make a contribution to the cash pool prior to insolvency, so that the parent company can withdraw such funds to the disadvantage of the subsidiary's creditors. If the transaction is annulled, the parent will have to pay back the sum representing the withdrawal.

Under the Serbian Companies Act, the majority shareholders and director of the company are not liable for damages caused to the company if they rely on professional advice in making business decisions. Thus, it is advisable that the majority shareholders and the company's

director seek professional advice from reputable financial advisors prior to having the company enter into the cash pooling arrangement.

Transactions between a company and its majority shareholders (or related persons) are deemed to be 'transactions involving a conflict of interest'. The conflict of interest can be pre-approved by (i) the majority of non-conflicted members of the board of directors; or (ii) in cases when there is no such majority, the non-conflicted shareholders. Failure to comply with this requirement will render the cash pooling agreement between the conflicting parties null and void.

Alternatively, the approval of non-conflicted board members/shareholders is not required in case it could be proven that the agreement entered into by conflicting parties is beneficial (to the company). Therefore, a "fairness opinion" on the effects of the "conflicted" cash pooling agreement, delivered by a reputable auditor, might be considered as the proof required under the Serbian Companies Act.

(2) Capital maintenance rules

The registered share capital of Serbian companies must meet the minimum amount required under the Serbian Companies Act. If the company's registered capital is not increased to the required level within six months, liquidation proceedings must be initiated.

Directors should therefore be careful to ensure that the company's contributions to the cash pool do not reduce the company's registered capital below the minimum required amount, since the Serbian Companies Act provides that directors may be fined for failure to maintain the minimum capital requirement.

In addition, the Serbian Companies Act provides that the company can not make distributions to its shareholders if:

(a) the company's net assets would be less than (i) its registered capital and (ii) the reserves of the company, after the distribution to the shareholder; or

(b) the company would be incapable of paying its debts as they become due in the ordinary course of business, after the distribution to the shareholder.

Withdrawals from the cash pool account by a parent company, and payment to the account by a subsidiary, should therefore not infringe these rules – or else there is a risk of invalid distribution.

2. Liability risks

As a general rule, the company's directors and majority shareholders should ensure that the company does not fall into insolvency, or, fail to maintain the minimum capital requirements, by reason of the cash pool arrangement. In addition, the shareholders and directors should be aware of the following:

a) Piercing of the corporate veil
The Serbian Companies Act provides for liability of the company's shareholders if they "misuse" the company for "illegal or fraudulent purposes" or if they use the company's assets for their own purposes. In such instance, the company's shareholders share a joint, several and unlimited liability for the unsatisfied debts of the company. In a cash pooling arrangement, such a situation may arise if, for example, the parent company withdraws the contributions of a subsidiary, depriving it of liquidity and forcing it into insolvency.

b) Criminal liability
The law imposes criminal liability on a director who causes insolvency to a company or causes damage to the company as a result of his failure to comply with relevant laws, constitutional documents (of the company) and obvious negligence in discharging duties. Thus, any inter-group

borrowing must not prejudice the interests of minority shareholders and creditors – if it does, the director risks criminal liability. To prevent this, the borrowing must be concluded on an arm's length basis (i.e. subject to standard market conditions) without causing any insolvency issues to the cash pooling participant.

c) Civil liability
Under the Serbian Companies Act, the company's majority shareholder and director may be liable to the company for damages the company suffers as a result of a breach of corporate legislation. In addition, the company's directors will be liable to third parties who incur loss as a result of actions taken by the directors that were beyond the scope of their powers. It is therefore important that directors implement cash pooling arrangements with due adherence to the minimum capital requirements and relevant corporate approvals.

3. Mitigating the risk

Given that there is no specific legal framework relating to cash pooling in Serbia, it will be hard to assess and mitigate all risks. However, it is important that the directors of the participating companies are assured that the benefits of the cash pooling arrangement outweigh the risks. The solvency of other participants is a key part in deciding this, as the insolvency of one participant could affect the solvency of all the others. Also, the conflict of interest and capital maintenance rules (as noted above) should always be carefully considered.

In addition, the articles of association of each entity that will be a party to the arrangement should be reviewed, with the view of obtaining all necessary corporate approvals prior to entering into any cash pooling arrangement, and ensuring compliance with any additional requirements contained therein that deal with restrictions on indebtedness of the entity or on the type of agreement the entity is permitted to enter into.

4. Tax issues

If the pool members are considered related parties for corporation tax purposes, the transfer pricing requirements should be observed. If interest rates are not given on the arm's length principle, arm's length interest rates should be applied in order to adjust the corporation tax base.

In addition, if the company is "thinly capitalised" within the meaning of Serbian corporation tax law, i.e. if related parties' loans exceed the equity by more than four times, the company shall not be able to deduct interest paid on the exceeding amount.

Slovakia

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As noted in the introduction to this brochure, many of the risks outlined in this Slovakian submission do not apply to a purely notional cash pooling arrangement. In practice, however, a notional cash pooling arrangement will frequently involve the grant of cross-guarantees and security by the participants to the bank in order to maximise the available overdraft facility. To this extent, many of the risks outlined in this Slovakian submission could be relevant, even if the cash pooling arrangement is predominantly notional in nature.

1. Legal framework and liability risks

Cash pooling arrangements are not subject to specific legal regulation in Slovakia. However, there are a number of issues relevant to cash pooling arrangements in Slovakian corporate, banking and criminal law.

a) Corporate law

There are three key principles under Slovakian corporate law that must be borne in mind when pursuing a cash pooling arrangement:

(1) The directors of a company must exercise the care and due diligence of a prudent businessman acting in good faith in the interests of the shareholders and the company's creditors. A breach of this duty will make the director liable to the company for damages caused by his breach.

Generally speaking, the primary obligation of a duly diligent director of a Slovak company, acting in good faith, is to prevent the company from falling into insolvency. For a director, this obligation is particularly pertinent as a breach of his duty will not only make him liable to the company, but also its creditors if they can not seek repayment of the debts they are owed.

Consequently, the concern of a director is that an inherent risk in cash pooling is that the insolvency of one participant may threaten the solvency of all the participants, exposing the directors to liability. The directors of cash pool participants will therefore need to take risk avoidance measures to protect the company. One such measure is to seek the ratification of the members of the company for the cash pooling arrangement. Under Slovakian company law, directors are not liable for damages caused to the company if they are carrying out the instructions of the members given by a decision of a general meeting (unless the instruction of the general meeting conflicts with legal regulation). Thus, once a cash pooling arrangement has been agreed it is advisable that the directors seek approval from the shareholders in a general meeting.

In addition, it is important that the directors of the company satisfy themselves that there is corporate benefit deriving from the cash pooling arrangement, outweighing its risks. The directors may wish to document such a consideration in the minutes of their meetings – as evidence that they have attempted to fulfil their duty to act in good faith.

(2) The shareholders of a company are normally liable for the obligations of the company up to the unpaid value of their shareholding to which they have obliged to contribute, as registered in the Commercial Register. However, pursuant to a written agreement (such as a cash pooling agreement) they may agree to be jointly and severally liable. The cash pooling agreement should therefore be carefully drafted to avoid this (as is further noted below).

(3) A Slovakian company may only transfer funds to its shareholders if it is a valid shareholder distribtuion, or is provided on arm's length terms (e.g. subject to a market rate of interest). Thus, if an intra-group loan from a subsidiary to a parent is found not to be at arm´s length then any sums transferred to the parent will be treated as an unlawful profit distribution or illegal capital repayment. Withdrawals from the cash pool account by the parent company, and payment into it by the subsidiary, should therefore not infringe these rules.

b) Banking law
Normally, the collection of deposits and the providing of loans in Slovakia require a company to seek a form of banking licence. However, there is an exception to this rule that, where companies are considered as related to each other and are providing loans or deposits from their own resources (and not from deposits they have received off others) then no licence is required. Thus, in relation to cash pooling, so long as the participants can demonstrate through clear lines of accounting that the monies contributed to the cash pool are from their own resources then the participants should not require a banking licence.

c) Foreign Exchange Act
Under the Slovakian Foreign Exchange Act (measure number 634/2008 Coll), a Slovak company must notify the National Bank of Slovakia of all relevant data concerning foreign assets and debts, if such assets or debts are, at the end of the month, higher than EUR 700,000. If the cash pooling arrangement operates on a cross-border basis, the Slovak company may therefore have to make a report.

d) Criminal law
A director may be found guilty of the criminal offence of fraudulent insolvency if, with the intent to cause damage to a third party or to provide for himself or a third party any unjustified benefit, he should cause the insolvency of the company and thereby prevent its creditors from seeking satisfaction of their debts.

In a cash pooling arrangement, such an offence is likely to be committed if, for example, the parent company is in need of liquidity and demands that a subsidiary contribute funds to the cash pool for its withdrawal. If the effect of such a transaction is to cause the subsidiary to have its own liquidity problems, resulting in insolvency, then the directors of the subsidiary who actively follow through on the parent company's demands may be guilty of fraudulent insolvency.

2. Risk management

Given that cash pooling arrangements in Slovakia are not subject to explicit legal regulation, it is unforeseeable that all legal risk can be eliminated. Nevertheless, the following possibilities should be considered:

a) Cash pool agreement
It is advisable to have a cash pool agreement between the participants that clearly states the duration of the arrangement, the rate of interest payable on any sums borrowed from the fund, and including provisions that enable the participants to withdraw from the arrangement on demand. The ability to withdraw from the arrangement is, as noted above, particularly important, and it should be coupled with a right to have deposited funds returned within 24 hours. This may enable the illiquid company to recover its cash-flow, whilst protecting the other participants should the withdrawer become insolvent.

b) Right of information
Although it may be sensible for an illiquid participant to withdraw from the cash pool, its withdrawal and the return of its deposited funds may cause illiquidity problems for the other participants who are relying on those returned funds. In light of this, it is sensible that the participating companies have a right to receive up-to-date information relating to the liquidity and equity of the participating companies, so that their directors can ensure that they are not over-reliant on funds sourced from any particular

participant; especially one that may have solvency issues. A practical way of doing this may be for the parent company to provide monthly consolidated accounts for the entire group.

c) Set-off agreement
It is advisable that the cash pooling agreement stipulates that payments made by the parent company to its subsidiaries by reason of cash pooling may be set off against any existing (or future) obligation of the parent to transfer funds to cover losses of the subsidiary.

d) Joint and several liability and security
As a general rule, the individual facility agreement entered into between the bank and the participating companies will provide that the participating companies are jointly and severally liable for any negative balance on the master account, and will require them to provide security. In addition, the standard terms and conditions used by banks in Slovakia contain provisions that create pledges over all of the accounts held with the bank by each of the participating companies. If possible, the participating companies should avoid such joint and several liability and the security and pledge provisions. If this is not possible then the company's liability should be restricted, at the very least, to the lesser of: (i) the actual amount of funds withdrawn from the cash pool by the company at any one time; and, (ii) the amount by which its net assets exceed the minimum required share capital at law.

e) Liability on a sale of a group company
If a company that has participated in a cash pooling arrangement is sold, the seller will usually ask for an indemnity regarding potential liabilities arising from the target's involvement in the cash pooling arrangement. One such liability (and indemnity) may be for capital maintenance matters, since the purchaser will be liable as an incoming shareholder for any payments previously made in contravention of capital maintenance provisions.

3. Tax issues

In the case of physical cash pooling, interest may be payable on intra-group borrowing by the participating companies. Such interest payments will be subject to the usual tax rules regarding interest – in particular, taxation of interest earned on sums lent, deductibility of interest incurred on sums borrowed and the thin capitalisation rules.

Slovenia

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1. Introduction

Cash pooling is offered only by a few banks in Slovenia, and is rarely included as part of their regular service. The concept of cash pooling is not regulated under Slovenian law, and there is also no case law to define it in any detail. Therefore, there are no specific provisions prohibiting cash pooling in Slovenia.

However, some other legal restrictions will apply to cross-border cash pooling. This is because legal entities with their seat in Slovenia must seek permission from the Bank of Slovenia for the opening of an account at a bank seated in a non-EU country. Cash pooling that includes entities with seats in Slovenia, utilising foreign bank accounts, will therefore require pre-authorisation.

2. Types

Cash pooling may be (a) intra-company or (b) intra-group. Furthermore, Slovenian banks offer cash pooling only in the form of the "zero-balancing" method – i.e. through a master account (treasury account), to which positive balances from each of the regular accounts are transferred. In addition, investigations have found that Slovenian banks do not offer notional cash pooling arrangements.

a) Intra-company cash pooling
In Slovenia, a company may open numerous regular bank accounts at the same, or, at different banks. In addition to a regular bank account, any company may also open separate accounts for its specific organisational parts. As a result, a company may have many bank accounts, spread across numerous banks. Intra-company cash pooling can therefore be an ideal option for any company or other legal entity having several bank accounts, since cash pooling can significantly reduce costs if there are differences between the accounts; such as some having net credit positions and others having net debit positions.

b) Intra-group cash pooling
Slovenian banks will also operate cash pooling arrangements for affiliated companies, whereby a bank opens a joint account (treasury account) for all affiliated companies. Funds from each of the regular accounts of the affiliated companies are then, at the end of each business day, transferred to the treasury account. In creating this arrangement the bank will enter into an agreement with the parent company, and each 'subsidiary' must authorise the parent company to open the joint account.

However, it should be noted that with intra-group cash pooling the profits of companies can be 'silently' transferred within a group, leading to potential liabilities and risks for the parties involved. To prevent this, careful protection should be put in place by the directors of the participating companies.

3. Liability risks

a) Director's liability
Every director of a company must act with the diligence of a conscientious and fair manager, and should not enter into agreements that are detrimental to the company. Thus, a director must not allow a company to enter into a cash pooling agreement if the company does not receive an adequate remuneration for its liabilities or contributions. This will be an issue in a cash pooling arrangement where mutual settlement of participating accounts (i.e. net credit for net debt) is of detriment to a participating company and the cash pooling agreement does not provide for proper compensation for loss of net credit.

A director will be liable to the company for damage arising as a consequence of a violation of his duties, unless the director demonstrates that he fulfilled his duties fairly and conscientiously. Creditors of the company may also pursue a compensation claim by the company against the director, if the company is unable to repay its debts.

b) Shareholder loan provisions
Since cash pooling is, by definition, a mechanism for providing intra-group loans, legal requirements as to shareholder loans may apply:

— When a member of a limited liability company (in Slovenian "d.o.o.") provides a loan to a company in such circumstances where he should, instead (acting with due diligence), have provided capital, then such member may not later pursue a claim against the company for repayment of the loan in bankruptcy or compulsory composition proceedings. The loan is considered to be a part of the assets of the company, for distribution to creditors.

— If the company repaid the loan in the year prior to commencement of bankruptcy or compulsory composition proceedings, then the member must compensate the company for a sum equal to the repaid loan amount.

The above mentioned rules also apply, like-for-like, to shareholders of a public limited company (in Slovenian "d.d.") who have more than a 25 per cent share in the voting rights of the company.

c) Capital maintenance rules
A company's equity may not be used to make payments, or give other benefits, to the company's shareholders – unless there is a shareholder resolution providing for such payment or benefit (distribution of dividends or share capital decrease) – these are known as the 'capital maintenance rules'.

Shareholders must return to the company all payments which they receive from the company, as dividends or assets, that are required to maintain the subscribed capital and reserves of the company, if they knew or should have known that they were not entitled to receive such payments (the 'capital maintenance rules'). Such demands for repayment may also be made by the company's creditors, if the company fails to pay its debts. If bankruptcy proceedings are commenced, the return of illegal payments may also be demanded by the bankruptcy administrator.

In a cash pooling arrangement, the share capital of subsidiaries must therefore not be repaid to the parent company. However, cash pooling may cause situations in which the parent is benefiting from its direct subsidiary's contribution into the cash pool. In case of such violation of the capital maintenance rules, the received amount must be repaid by the parent company.

d) Agreement between business enterprises (in Slovenian "podjetniške pogodbe")
The Slovenian Companies Act regulates two specific types of agreements between companies, known as "undertaking contracts":

— a profit transfer contract: one company undertakes to transfer its entire profit to another company; and

— a contract on the partial transfer of profit: one company undertakes to transfer part of its profit, or the profit of its individual establishments, in full or in part to another company.

A cash pooling agreement may therefore be considered as an undertaking contract. In such instance, a shareholders' meeting should approve the agreement (as an undertaking contract) with a majority of at least three-quarters of the capital that is represented at the vote.

4. Mitigating the risk

As noted above, a cash pooling agreement has to be of benefit to all companies entering into the agreement. The directors of the participating companies should therefore ensure that, on balance, the arrangement is of benefit to their company – and, it is suggested, document the same in the minutes of a board meeting.

Interest paid to a company contributing funds to the master account, and interest paid by a company borrowing funds from the master account, should be determined by the cash pooling agreement.

5. Tax issues

a) Transfer pricing
Generally, if cash pooling is detrimental to any of the participating companies, there is a risk that the tax authorities will increase such company's tax base for income tax purposes – by the difference between the balance of actually received interest and the interest that would have been paid on a positive balance, if cash pooling had not been carried out.

Also, if interest is not agreed at arm's length, it will be considered as a hidden transfer of profits. This arm's length principle also applies to any handling fees, i.e. fees charged (or that should have been charged) by the company holding the cash pool account (to the other participants).

b) Non tax-deductible interest
Interest on loans received from persons whose registered office or place of actual management or place of residence is in a country other than an EU member state, where the general and/or the average nominal profit tax rate is below 12.5%, and such country is listed on a list published by the Ministry of Finance, is not recognised as a tax-deductible expense.

c) Thin capitalisation
The thin capitalisation rules may apply to interest paid in respect of the cash pooling agreement. Except in the case of loan recipients that are banks and/or insurance undertakings, interest paid on loans received from a shareholder or partner that holds (directly or indirectly, at any time during the tax year) at least 25% of the capital or voting rights of the taxpayer is tax deductible if the loan does not exceed four times the amount of the shareholder's or partner's holding in the company's share capital. If the loans exceed the shareholder's or partner's holding by more than four times, the company cannot deduct interest paid on the exceeding amount and must pay income tax (of 20%) on such interest; unless the company provides evidence that it could have received the surplus from a lender whom is a non-associated enterprise.

The amount of the shareholder's or partner's holding in the share capital of the company is determined (for the tax period) as an average on the basis of paid-in capital, retained earnings, and reserves as at the last day of each month in the tax period.

Loans provided by third parties, including banks, for which a shareholder or partner gives a guarantee, and loans provided in connection with a deposit by a shareholder and/or partner, are also deemed to be "loans" within the jurisdiction of the thin capitalisation rules.

d) Interest between associated companies
In determining the revenue generated from interest charged on loans provided to an associated company, the Slovenian tax authorities will use an interest rate not lower than the level of the most recently published, known or recognised interest rate at the time of approval of the loan; unless the taxpayer proves that in equal or comparable circumstances a loan would also be granted to a loan recipient of a non-associated enterprise at a lower interest rate.

In determining the expense incurred from interest charged on loans received from an associated company, the Slovenian tax authorities will use an interest rate not higher than the level of the most recently published, known or recognised interest rate at the time of approval of the loan; unless the taxpayer proves that in equal or comparable circumstances a loan would also be granted by a non-associated enterprise at a higher interest rate.

The recognised interest rate comprises a variable and a fixed component. The Ministry of Finance publishes the variable component of the acknowledged interest rate on a monthly basis. The applicable variable component differs, based on the currency and maturity of the loan. A mark-up is determined in basis points (1/100 of %) and depends on the debtor's credit rating according to Standard & Poor's methodology and the maturity of the loan.

The rule on interest between associated companies applies also to transactions between associated Slovenian companies where that company:

— discloses an uncovered tax loss, forwarded from previous tax periods, for the tax period for which revenue and expenses are determined; or

— pays tax at a 0% rate or at a special tax rate lower than the general tax rate; or

— is exempt from paying corporation tax.

e) Withholding tax (application of double tax treaties)

As a general rule, tax will be calculated, withheld and paid at a rate of 15% on interest payments, except for interest:

— on loans issued in Slovenia, where the receiver has notified the payer of his/her tax number;

— on loans raised and issued by an authorised institution, in accordance with law regulating insurance and financing of international business transactions, for which guarantees are issued in Slovenia; and

— paid by banks – other than interest paid to companies whom have their seat, or place of effective management, or residence, in a country other than an EU member state, where the general and/or the average nominal company tax rate is lower than 12.5% and the country is listed on a list published by the Ministry of Finance.

Tax will also not be withheld on interest paid to a non-resident, who is resident of an EU and/or EEA member state, and is a taxpayer in such state, provided that:

— the interest is not paid to a Slovenian business unit of the non-resident;

— the non-resident cannot claim the withheld tax in its country of residence (because, for example, it claims exemptions on dividends from the tax base); and

— the purpose of the transaction is not tax avoidance.

Furthermore, the tax will not be withheld on interest payments made to companies assuming a form to which the common system of taxation for interest payments made between associated companies (of different EU member states) applies, as laid down by the minister responsible for finance, provided that, at the time of payment:

(1) the interest payments are made to the beneficial owner of a company of an EU member state (other than Slovenia) or a business unit of a company of an EU member state (other than Slovenia); and

(2) the payer and the beneficial owner are related, so that:

— the payer of the tax directly participates in the beneficial owner's share capital by at least 25%; or

— the beneficial owner directly participates in the share capital of the payer by at least 25%; or

— where participation between companies of the EU is concerned, a parent company directly participates in the capital of both the beneficial owner and the payer by at least 25%;

and in each instance, the duration of the minimum 25% participation is at least 24 months; and

(3) the payer or the beneficial owner is:

— a company assuming a form to which the common system of taxation for interest payments and royalty payments made between associated companies of different EU member states applies, and which are laid down by the minister responsible for finance;

— in accordance with the tax laws of an EU member state, are considered to be residents in that state for tax purposes and, under the terms of a double taxation agreement concluded with a third state, are not considered to be residents outside the EU; and

— a company subject to either one of the taxes to which the common system of taxation for interest payments and royalty payments made between associated companies of different EU Member States applies, that are laid down by the minister responsible for finance, where a company exempt from tax is not deemed a taxpayer, or, subject to a tax which is identical or substantially similar, and is additionally introduced, or replaces, the existing tax.

To apply for this exemption, permission from the Slovenian tax authority must be sought.

Finally, withholding tax may be reduced or even completely eliminated if interest is paid to a company resident of a country with which Slovenia has concluded a double tax treaty providing for withholding tax relief/exemption.

Ukraine

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There is no specific legal framework that governs cash pooling in Ukraine. One may say that the concept of cash pooling has not been widely developed. However, Ukrainian law does allow companies to enter into certain arrangements that, to some extent, have similar commercial effects as the standard cash pooling concept.

1. Types of Arrangements

a) Physical cash pooling
Since the transfer of funds between Ukrainian legal entities must be based on contractual obligations, physical cash pooling can be achieved in Ukraine through the following types of arrangement:

(1) Refundable financial assistance ("RFA")

With RFA, a company receives interest-free funds for a defined period of time under a financial assistance agreement. An RFA is therefore an interest-free loan, which enables one or more group companies to make a liquid sum of funds available to other group companies, in a similar manner to physical cash pooling. It is recommended that an RFA be entered into pursuant to a written agreement with a term of up to three years. If this term is exceeded, the money lent will be treated as profit and will be subject to corporation tax at 25%.

An RFA agreement designed to facilitate cash pooling should clearly establish the rights and obligations of the participating parties, so that the basis on which they will provide funds to each other is certain. Alternatively, the RFA agreement may provide that companies will receive funds from a defined company within the group – such defined company having collected the funds from the other participating companies.

Should the cash pool participants wish to extend their arrangement beyond three years, they will need to enter into new ones at the end of each three year-period.

However, due to legal uncertainty and local currency restrictions, it appears that only tax-paying Ukrainian companies that are subject to general tax treatment may participate in an RFA. In addition, the monies subject to the arrangement must be denominated in the Ukrainian currency (hryvnia).

(2) An interest-bearing loan

An alternative structure for a cash pooling arrangement in Ukraine is to make use of a standard interest-bearing loan, pursuant to a loan agreement. To optimise this, the parties may opt for borrower friendly terms on repayment and interest.

However, it is important to note that if one of the contributing participants is a non-resident, the loan agreement shall be subject to registration with the National Bank of Ukraine. In addition, a key qualification on this structure is that, to provide a loan, a corporate Ukrainian entity has to have special authorisation.

(3) Alternatives for branch offices

For branch offices that do not have the status of a legal entity and are separate subdivisions within a parent company, some Ukrainian banks offer automatic transfers of positive balances on their accounts to a master account of the parent company; thereby achieving a "zero balancing" or "target balancing" effect.

b) Virtual cash pooling
Some Ukrainian banks do offer groups of companies a "virtual" cash pooling service. However, such a service has yet to be tested for its legal enforceability in Ukraine.

2. Reducing risk

Given that there is no specific legal framework surrounding cash pooling in Ukraine, there is some legal uncertainty. It will therefore be hard to mitigate or eliminate all risks. This is especially true considering the above noted arrangements have not been tested in Ukraine, in a cash pooling context, for some time. Nevertheless, it is advisable that the following risk avoidance measures are borne in mind when carrying out a cash pooling transaction:

— To reduce risks, all necessary corporate approvals (required pursuant to a company's constitution) must be obtained prior to entering into the cash pooling arrangement, or else the directors risk an ultra vires situation, making the agreement void. In addition, the directors should have all the necessary powers to enter into the RFA, loan agreement or any other agreement entered into in connection with the cash pooling arrangements on behalf of the company, to avoid abuse of power.

— It is also advisable that contributing participants have the right to terminate their participation in the arrangement, and receive repayment of any sums contributed (together with accrued interest, if applicable) on demand. This will allow the contributor to seek the return of its contributions should it be faced with its own liquidity issues, whilst also ensuring that it can take the contributions back if another participant in the cash pooling arrangement has solvency problems threatening to swallow the pooled cash.

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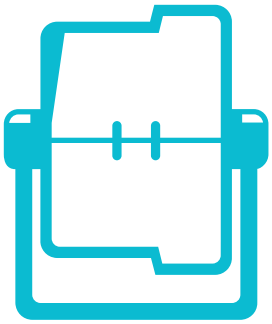

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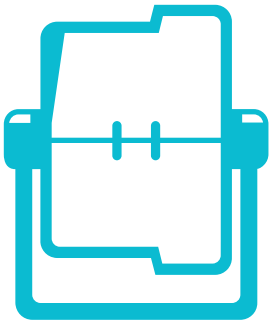

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