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 granting and repayment of intra-group loans.
In addition to physical cash pooling, there is also “notional” (or “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 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 granting 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 and discusses the various means by which such liability may be avoided.

Stefan Brunnschweiler
Head of CMS Corporate/M&A Group

Alexandra Schluck-Amend
Partner and Editor
Cash pooling is not a familiar concept in Albania and the Albanian law is silent on many issues of concern.

Although there is no specific legislation on cash pooling, it is important to ensure that any cash pooling structure meets the requirements imposed by general corporate and banking regulatory provisions.

Further, while considering the implementation of cash pooling structures in Albania a number of relevant tax issues shall be addressed.

a) Social interest and due diligence
As a general rule the directors and shareholders of an Albanian company are obliged to act in compliance with the interests of the company and of the other shareholders.

Concerning the interests of a company, a mere interest of the group would not suffice to execute a cash pooling agreement providing financial support to another company of the group which is currently suffering financial difficulties. The participants’ protection shall prevail or at least be balanced between the interests of the group and the interests of the participant company shall be reached.

Pursuant to the Albanian Law on Entrepreneurs and Commercial Companies (Law No. 9901/2008 as amended), company directors are required to perform their duties in good faith, with professionalism and due diligence.

Company directors shall therefore assess the risks deriving from cash pooling with due care and diligence in the best interests of the company itself.
b) Shareholder’s loan provisions
Cash pooling in Albania triggers the application of the general provisions on shareholder’s loans and related restrictions.

As a rule, it is envisaged that the remuneration for any legal transaction implemented between the company and a shareholder shall not exceed the value applied to similar transactions on the relative market.

If a shareholder has granted a loan to a company on terms which are less favourable than those usually applied on the market and the company is in adverse balance, the shareholder is not entitled to claim the payment should this repayment reduce the capital of the company below the minimum established on approx. EUR 1 for a limited liability company (hereinafter “SHPK”), approx. EUR 26,000 for private offer joint stock companies and approx. EUR 74,000 for public offer joint stock companies (hereinafter jointly “SHA”).

The same provision is applied to any transaction financially comparable to a loan entered into by and between the shareholder and the company.

In addition, Albanian corporate law provides for the prohibition of the sole director, being at the same time sole shareholder, to execute a loan agreement with the company itself.

Finally, as regards the company directors of a limited liability company, as well as all members of the Supervisory Council/Board of Directors and directors of a joint stock company, it is established that they are allowed to enter into a relationship with the company only if all information on the condition and type of agreement to be executed is disclosed. Such agreement should be approved by the shareholders of the company and should be notified at the Commercial Registry.

c) Liquidity protection
Prior to entering into a cash pooling agreement, the directors of an Albanian company shall consider the financial impact with particular concern to liquidity protection. They might be liable to personally honour the debts of the company if they fail to guarantee that the company is in a position to meet its commitments against third parties.

d) Hidden distribution of profits
An SHPK in Albania may resolve a distribution of profits to its shareholders only if such distribution enables the company’s assets to fully cover the liabilities and the company to have sufficient liquidity to perform the payment of obligations that are due in the following twelve months.

An SHA may resolve a distribution of dividends only after the amounts earmarked for legal and statutory reserves have been deducted.

In both cases hidden distribution of profits is not permitted and the company directors shall be personally liable for their return.
e) Insolvency proceedings – contestation of transactions
Cash pooling can become disadvantageous in cases where participants or header account holders become insolvent.

As regards the insolvency proceedings, the participants in a cash pooling structure in Albania should bear in mind that the bankruptcy administrator may consider a transaction that “disadvantages bankruptcy creditors” to be invalid if it has occurred within three months prior to the request to commence the proceedings or after the proceedings have started.

To declare such invalidity it is required that at the time of the transaction the other party be aware or – as a result of gross negligence – be unaware of the illiquidity of the debtor or of the request to open the proceedings.

Moreover, a transaction may be treated as invalid when the debtor has entered into a transaction – up to ten years before the request to commence the proceedings – with the intention to disadvantage his/her creditors and if the other party was aware of this intention, the debtor’s illiquidity or the effect of the transaction on creditors.

2. Liability risks

When setting up a cash pool structure various liability risks may become relevant, especially with reference to the directors and shareholders of the participant company.

a) Liability of directors
As anticipated above, the directors of an Albanian company are liable to act in good faith and in the best interests of the company, avoiding any conflict of interest and exercising their proper competencies only for the realisation of the company’s goals and expectations.

Directors that violate their duties and professional standards are jointly liable towards the company by reimbursing all damages and returning all income gained.

Directors especially shall be held liable for illegal return of the shareholder’s contribution, payment of interest and dividends, distribution of assets, granting of loans and continuance of economic activity of the company in insolvency situations.

A member of the management body is exonerated from its liabilities against the company when it is proven that he has acted in good faith and with diligence.

The company may act in court against the director within three years as of the occurrence or disclosure of the breach claiming compensation and/or nullity of actions.
b) Liability of shareholders
The shareholders of both SHPK and SHA as a rule are not held liable with respect to the corporate governance of their companies.

However, in view of the implementation of a cash pooling system, some general principles shall be considered especially in relation to the control, supervision, management and compliance of the company.

The liability of the shareholders is mostly related to abusive and misleading actions taken against the interests and properties of the company. In the context of cash pooling, the link between the abusive and misleading actions performed during the implementation of the structure and the consequent adverse financial situation endured by the company should be established.

Further, the shareholders are presumed to be informed of the financial performance of the company, and if the latter is facing financial problems, they should undertake the proper measures.

Still the provision of the liability of shareholders deriving from the presumption of being informed with regard to the financial solvency/insolvency of the company is not very well defined. In any case it is limited to up to the total value of the obligations of the company towards a third party, raised after the moment when the shareholders were informed about the financial solvency/insolvency of the company.

3. Legal structure

Given that the law in Albania is under development and subject to frequent amendments, it is difficult to totally avoid potential risks and liabilities related to the selection of the right legal structure of cash pooling. However, the following points shall help to mitigate the aforementioned risks and liabilities.

a) Corporate power
Albanian law is silent on whether the shareholders need to favourably resolve to authorise the company to execute a loan agreement. Thus, it is to be considered that the shareholders’ approval is required if it is provided in the Articles of Association of the company.

b) Cash pooling agreement
Although the Law on Entrepreneurs and Commercial Companies does not provide for any mandatory form to be compliant with the agreement governing the shareholders’ loan, it is highly advisable to opt for a written agreement in the event of a cash pooling structure.

Further, a cash pooling agreement shall work in synchrony with the provisions of the facility agreement with the pooling bank, which in many cases opt for a standardised one.

Albanian law is silent on the obligation of the parties to comply with notification of the agreement to any relevant regulatory authority.
c) Facility agreement
Given the lack of specific regulation, the agreement executed between the pooling bank and the participating companies triggers the application of general rules on loan agreements.

Nonetheless it is conceivable that it provides, with particular reference to the termination right of individual participating companies, for the right to prompt and updated information on the pooling balance and for the respective contributions and liabilities.

d) Guarantee
The participant’s protection has also to be considered when the bank offering the cash pooling demands a guarantee from the participant for a debit position. The guarantor should consider if a timely revocation of such a guarantee can be effected.

A person managing a single member company must not enter into guarantees. Otherwise there are no explicit restrictions that a company can guarantee the borrowings of one or more other members of its corporate group.

If the company incurs a contingent debt from the guarantee amounting to more than 5% of the company’s annual turnover of the last business year, the legal representative (i.e. director) would normally seek an approval from the Board of Directors of the company.

4. Tax issues

The concept of cash pooling is not specifically defined in Albania’s tax laws and there is uncertainty as to the provisions relevant to cash pooling arrangements.

In the event of a physical shareholder’s loan, interest may be payable on sums lent and borrowed by the participating companies. Such interest payments will be subject to the usual interest on tax rules – in particular, taxation of interest earned on sums lent, deductibility of interest incurred on sums borrowed and thin capitalisation issues.

Under Albanian income tax legislation, all expenses incurred for the purpose of generating, ensuring or maintaining taxable income of a company are deductible. This includes interest expenses on loans under a shareholder arrangement. However, if thin capitalisation rules are breached any interest expenses claimed as a deduction are void and tax liability applies.

a) Thin capitalisation rules
If the total debts of an Albanian company exceed four 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.
Generally, the parties are free to determine a rate of interest that will be charged on loans under the shareholder arrangement, but regard should be given to the thin capitalisation and related parties’ transactions legislation. 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.

**b) Interest deductibility**

The tax-deductibility of interest should be recognised by the Albanian tax authority, as long as the loan serves the business purposes of the taxpayer. There is anyway a limitation: Interest paid, which exceeds the average interest rate for 12-month loans on the banking market, according to an official publication of the Bank of Albania constitutes non-deductible expenses.

**c) Transfer pricing**

If the principle of arm’s length does not apply, the Albanian 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 given to the OECD’s transfer pricing guidelines.

The following transfer pricing requirements have to be complied with by the Albanian companies:

— yearly notification to the Albanian tax authorities of related party transactions and
— maintaining 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 be suitably evidenced in documentary form.

**d) Withholding tax**

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

**e) Corporation tax**

Any income earned from interest earned in a cash pool forms part of the general accounting pretax profits of a company, and is taxed at the rate of 15%.

**f) VAT rules**

Financial services (such as lending) are VAT exempted.
In Austria, risks of liability in relation to cash pooling arrangements arise if one of the companies involved becomes insolvent or if capital maintenance provisions are not complied with. The legal framework governing cash pooling in Austria comprises statute on the one hand and jurisprudence of the Supreme Court (OGH) on the other.

a) Capital maintenance
A cash pooling arrangement must comply with the principle of capital maintenance and the resulting legal requirements. As a general rule, capital-based companies (i.e. limited liability companies (GmbHs) and stock corporations (AGs)) may not reduce their share capital by repaying contributed capital to the shareholders. Such a repayment will constitute an unlawful distribution under section 82 of the Limited Liability Companies Act (GmbH-G) and section 52 of the Stock Corporation Act (AG). Shareholders are only entitled to receive proceeds in the form of distributed profits (dividends) or funds (if any) remaining after satisfaction of liabilities to creditors on liquidation of the company.

b) Disguised unlawful distribution
A company is not permitted to make payments to shareholders (other than the distribution of the net profit as shown in the annual financial statements) or perform services to a shareholder in respect of which the company does not receive adequate remuneration (disguised unlawful distribution). If the shareholder receives a benefit merely by virtue of his position as a shareholder, this constitutes a breach of the rule of capital maintenance. Transactions with the company must be conducted at arm’s length. The relevant test here is whether the directors are acting with the due care which a prudent businessman would have acted with if he had made the same deal in the same circumstances with a third party not affiliated to the company. The directors’ actions are presumed to be in accordance with the requirement of due care, if respective decisions were made pursuant to the provisions of the business judgment rule (which has been implemented into the Limited Liability Companies Act and the Stock Corporation Act in 2016).
The general terms and conditions of banks in Austria often require the granting of guarantees by affiliated companies. A company which guarantees the debts of the parent or another affiliated company could be breaching the rule of capital maintenance if such guarantee is not justified. In order to assess whether the guarantee is justified, the directors of the company providing the guarantee must rate the credit standing of the parent/treasury company. Furthermore, a company granting loans to – or guarantees in respect of the obligations of – other group companies or shareholders must receive adequate consideration. It is unclear what is deemed adequate. Standard interest rates are generally the minimum but may not always be appropriate, since the company in question is not normally a bank and therefore has a different risk structure.

In a decision in 2005, the Austrian Supreme Court ruled that such a guarantee may be justified by the specific internal/operational characteristics of a company. In this case, a limited liability company and its minority shareholder took out a loan together. Both were liable for the complete repayment, even though the funds were used solely by the individual and not the company. The company, acting as co-debtor, essentially performed the function of a guarantor. The Court decided that although the company had not received adequate remuneration for acting in this capacity, the close economic collaboration between the company and the shareholder (close to interdependence) justified the transaction and the risk incurred. The cited decision has since been reconfirmed in further rulings of the Austrian Supreme Court.

c) Equity substitution law
If a shareholder grants a loan to a company in financial difficulty (i.e. loss of creditworthiness or need for an additional equity contribution), such loan will be regarded as equity capital. As a consequence, the shareholder is not entitled to repayment of the loan for as long as the company remains in financial difficulty. Any such repayment constitutes a disguised unlawful distribution.

In 2004, the Equity Substitution Act was enacted. This Act imposes a freeze on the repayment of equity-substituting loans granted by a shareholder who has a controlling position (as defined in section 5 of the Act), an indirect shareholder or an affiliated company. Equity-substituting loans are loans granted by such persons during a period of financial difficulty (defined as insolvency, over-indebtedness or an equity capital ratio below 8% together with a fictitious period of debt redemption of more than 15 years).

The general terms and conditions of banks in Austria often require the granting of guarantees by affiliated companies. A company which guarantees the debts of the parent or another affiliated company could be breaching the rule of capital maintenance if such guarantee is not justified. In order to assess whether the guarantee is justified, the directors of the company providing the guarantee must rate the credit standing of the parent/treasury company. Furthermore, a company granting loans to – or guarantees in respect of the obligations of – other group companies or shareholders must receive adequate consideration. It is unclear what is deemed adequate. Standard interest rates are generally the minimum but may not always be appropriate, since the company in question is not normally a bank and therefore has a different risk structure.

In a decision in 2005, the Austrian Supreme Court ruled that such a guarantee may be justified by the specific internal/operational characteristics of a company. In this case, a limited liability company and its minority shareholder took out a loan together. Both were liable for the complete repayment, even though the funds were used solely by the individual and not the company. The company, acting as co-debtor, essentially performed the function of a guarantor. The Court decided that although the company had not received adequate remuneration for acting in this capacity, the close economic collaboration between the company and the shareholder (close to interdependence) justified the transaction and the risk incurred. The cited decision has since been reconfirmed in further rulings of the Austrian Supreme Court.

c) Equity substitution law
If a shareholder grants a loan to a company in financial difficulty (i.e. loss of creditworthiness or need for an additional equity contribution), such loan will be regarded as equity capital. As a consequence, the shareholder is not entitled to repayment of the loan for as long as the company remains in financial difficulty. Any such repayment constitutes a disguised unlawful distribution.

In 2004, the Equity Substitution Act was enacted. This Act imposes a freeze on the repayment of equity-substituting loans granted by a shareholder who has a controlling position (as defined in section 5 of the Act), an indirect shareholder or an affiliated company. Equity-substituting loans are loans granted by such persons during a period of financial difficulty (defined as insolvency, over-indebtedness or an equity capital ratio below 8% together with a fictitious period of debt redemption of more than 15 years).
2. Liability risks

If payments are made in breach of the principle of capital maintenance by way of a (disguised) unlawful distribution, the company will have the right to claim repayment. Such breach also leads to personal liability of the directors and possibly also of the (indirect) shareholders of the companies involved. The risks of liability become particularly significant in the event of insolvency of the companies concerned or where any of the companies concerned are sold.

a) Liability of directors
The directors of a company are liable for any losses incurred by the company which arise from their failure to apply the due care of a prudent businessman in managing the company’s affairs. In relation to cash pooling, the requirement to act with the due care of a prudent businessman means that the company should only participate in the cash pooling arrangement if it can be ensured that the company’s liquidity will not be adversely affected by its participation and that the funds the company transfers will be repaid. This requires regular, up-to-date information on the financial situation of all participating companies to be available. If the group has solvency problems, the cash pooling agreement should be terminated. Furthermore, as mentioned above, the directors are personally liable if, in contravention of the capital maintenance provisions, payments are made out of company assets in favour of a shareholder without the company receiving equivalent remuneration.

In respect of stock corporations, it is not fully clear whether – as proposed by the prevailing view – the company may waive such claims by unanimous resolution of the shareholders (if this can be obtained). In any event, however, claims by creditors cannot be waived by the company and will not be affected by any such resolution. In general, a director’s liability cannot be waived before five years have elapsed.

The directors of limited liability companies are bound by any instructions issued by the shareholders’ meeting. Directors acting in accordance with such instructions are generally not liable unless the instruction – and therefore its implementation – contravenes the law. Moreover, directors remain liable to the extent that compensation is needed to settle claims of creditors.

b) Liability of the parent company’s directors
The directors of the parent company may be personally liable in the event of insolvency of a subsidiary if they have interfered in a manner threatening the company’s existence or, in the case of a limited liability company, they have issued unlawful instructions (by way of shareholder resolutions).

c) Extent of due diligence to be conducted by the pool bank
In the event of collusion in relation to a disguised unlawful distribution, the company has the right to refuse the repayment of a loan to the bank. The Austrian Supreme Court stated in a decision in 1996 (Fehringer case) that a participating third-party loan creditor (such as the pool bank) has a general duty to make enquiries. Such duty would be fulfilled by the bank requesting information from the boards of the company. However, the decision of the Austrian Supreme Court in 2005 (referred to above) limits this duty to cases where there is a strong suspicion of disguised unlawful distribution. This decision has been confirmed by the Austrian Supreme Court in further rulings.
d) Further risks
It is discussed whether the grant of shareholder loans constitutes a banking operation requiring a banking licence. This is particularly relevant for the parent company (or any special treasury company) and its directors. It is assumed that the treasury company of a cash pooling agreement will not require a banking licence; however, a definite clarification in this regard does not exist. If shareholder loans are provided according to the equity substitution law a banking licence is not needed.

3. Legal structure to reduce liability risks

a) Cash pooling agreement
In order to reduce the risks of liability arising from a cash pooling system, it is necessary for the cash pooling agreement to contain information and termination rights for each Austrian company involved. However, despite the 2005 ruling of the Austrian Supreme Court mentioned above (which only defined some crucial points), several issues remain open. Therefore the preconditions and the limits of a cash pooling arrangement are not clearly established.

(i) Risk evaluation before signing the cash pooling agreement
In order to reduce their liability risks, the directors of the participating companies must satisfy themselves in advance that the benefits of the cash pooling arrangement (e.g. more favourable banking terms, better liquidity management, etc.) outweigh the possible risks. It is particularly important to consider the solvency of the parent/treasury company and the other companies involved. A company planning to participate in a cash pooling arrangement should, at least, have access to the latest balance sheets of the other participating companies and obtain information in relation to the present and expected future profitability and financial situation of the group.

(ii) Rights to information while participating in the cash pooling arrangement
The participating group companies will only be able to ensure timely repayment of the funds they transfer if they are continuously given information about the financial situation (in particular, the situation as regards liquidity) of the parent/treasury company and of the group. The cash pooling agreement should therefore include rights to information and of inspection in relation to matters affecting the cash pool.

(iii) Adequate interest payment and cost distribution
The companies involved are either granting loans by transferring the liquid funds or they become borrowers by drawing upon the liquid funds. To ensure that such loans are issued on arm’s length terms (to avoid disguised unlawful distribution), the receiving company must pay an adequate rate of interest. Furthermore, the costs of the cash pooling arrangement and moderate remuneration for the administrative services performed by the parent/treasury company should be split evenly between the members of the group.
(iv) Right to terminate the cash pooling arrangement

The termination clause is essential. Austrian 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 (seriously) endangered by the financial situation of other participants. Moreover, it should be agreed that payments from and to the participating companies may be set off against each other.

b) Facility agreement with the bank

The facility agreement of the group with the bank should reflect the terms and conditions of the cash pooling agreement (namely the termination rights of each company) in order to reduce the risk of liability. Modifications of the conditions concerning the pool bank should only be permitted if all the participating companies agree – not just the parent company.

(i) Limitation wording in respect of cross-guarantees

In general, banking agreements include a provision that all participating group companies are liable jointly and severally for the balance on the master account, or that they have to provide adequate security for their obligations. In addition, the general terms and conditions of banks always provide for a lien covering all accounts of each of the group companies with the bank. The group companies involved should avoid such joint and several liability. If this is not possible – due to the requirements of the account-holding banks – the liability should at least be restricted to the amount of funds drawn from the cash pool by the respective company. The liability of a company should be fully excluded to the extent that a claim jeopardises the existence of such company.

c) Warranties and representations in the event of the sale of a group company

Where a group company which has been involved in a cash pooling arrangement is sold, the seller should ask for an indemnity regarding potential liabilities of the seller and the remainder of its group arising from the cash pooling arrangement. The seller should avoid any guarantee or indemnity with regard to capital maintenance provisions.

The buyer should ask for representations and warranties that the capital maintenance rules have been complied with (and for an indemnity in the case of contravention), since as a new shareholder the buyer could be liable for payments previously made in contravention of the capital maintenance provisions.
Although there are no specific provisions in Belgian law governing cash pooling agreements, a cash pooling arrangement could trigger the application of the Belgian corporate law provisions on social interest, capital maintenance, directors' obligations and corporate capacity.

1. Social interest

Under Belgian law, directors must exercise their function in accordance with the interests of the company. Should they fail to consider the company’s interests, they may be held personally liable.

In various cases, however, the Belgian courts have been willing to balance the interests of the company against those of the group as a whole and, increasingly, case law and literature recognises the concept of the “interests of the group”. According to this concept, an individual group company is not to be treated in isolation without regard to the links which unite it with other companies in the group.

Whilst there is no strict legal definition of “interests of the group”, a definition has been roughly outlined in case law and doctrine, and was confirmed by a judgment of the Court of Appeal of Brussels dated 29 June 1999. This judgment (which in fact related to a criminal law matter) outlines the circumstances in which a group company may incur a financial detriment to ensure the best possible coordination of the group’s activities and the best possible results for the group as a whole. The case established that a group company can provide financial support to another group company which finds itself in financial difficulty, provided that such support is justified taking into account the interests of the group as a whole and does not endanger the existence of the company providing the support and is only provided temporarily.

However, the principle of “interests of the group” is subject to the following limits:

— the group cannot forfeit one of its subsidiaries in the sole interests of the group;
— the group cannot impose a long-term imbalance between the respective commitments of the companies in the group;
— the group must be well organised and structured and its members must have common financial and commercial objectives.

Furthermore, it remains at all times essential to maintain the balance between the interests of the group and those of the company providing the financial support.
2. Capital maintenance rules and directors’ obligations

Article 633 of the Belgian Company Code provides that if the net assets of a company fall to a level below half its share capital, a shareholders’ meeting must be convened by the directors within two months of their becoming aware of this fact, to consider whether the company should be put into liquidation. If the directors fail to convene a meeting within the requisite time period, they will be responsible for losses to creditors which arise from transactions they enter into with the company after the latest date on which the meeting should have been called. The damage suffered by third parties is deemed to flow directly from this failure, unless evidence can be provided to the contrary. This is a significant risk that Belgian directors need to consider.

Article 634 of the Belgian Company Code applies when the net assets of a company fall below the legal minimum of EUR 61,500. In such circumstances, any interested party can make an application to the court under this article for dissolution of the company. The court can grant the company a period in which to increase its assets to the legal minimum.

The obligation of the directors to convene a general meeting pursuant to Article 633 applies not only at the time the annual accounts are prepared but endures throughout the financial year – for example, on preparation of the interim accounts. However, this does not impose an obligation on the directors to take positive steps to check at any particular time whether or not the net assets of the company have fallen below the relevant thresholds.

As mentioned above, the directors of a Belgian company need to ensure that, when entering into a cash pooling arrangement, the balance is maintained between the interests of the company on the one hand and the interests of the group on the other. The interests of the company and the group will cease to be balanced if the Belgian company finds itself in either of the situations referred to in Articles 633 and 634 of the Company Code. In several cases, the courts have been of the opinion that in such circumstances, the interests of the Belgian company must not be compromised for the benefit of the interests of the group.

3. Corporate capacity – objects clause

The articles of association of a Belgian company should include the objects of the company. The authority of the company’s board of directors is limited by such corporate objects, i.e. the board of directors may only act on behalf of the company if its actions fall within the scope of the company’s objects. If the board takes any action that is outside the scope of the company’s objects, the directors may be held liable to the company and third parties.

Under Belgian law, cash pooling activities need not be expressly included in the company’s objects. However, it is necessary that the objects clause should allow the company to lend and borrow monies to and from other companies, and (if applicable) grant guarantees.
4. Interest rate

If the Belgian company contributes to the cash pool (rather than simply benefiting from funds contributed by others), it is absolutely necessary that the cash pooling agreement should specify the interest rate at which the Belgian company contributes such funds. This interest rate should not be lower than the official interest rate, since an interest rate which is lower than the official rate might not be considered to be in the corporate interests of the Belgian company.

5. Rules restricting companies’ indebtedness for creditor protection purposes

The directors of a Belgian company have a specific duty to preserve the company’s assets and to refrain from entering into transactions that may adversely affect the financial viability of the company or its assets.

The directors of a Belgian company must therefore carefully evaluate all possible consequences of the company’s participation in a cash pooling arrangement in order to ensure that they comply with this duty. In particular, the directors must consider – with reference to the contractual structure of the cash pooling arrangement – the extent of the risk that the Belgian company will be unable to recover sums it has contributed to the cash pool.

6. Thin capitalisation rule

Since 2012 a 5:1 debt-to-equity ratio applies in Belgium. Under the thin capitalisation rule, interest is not deductible where

(i) the recipient is a company belonging to the same group and
(ii) the total amount of related loans is more than five times the aggregate of the company’s taxed reserves and paid up capital.

This 5:1 thin capitalisation rule provides for some limited exceptions, as well as for a netting mechanism for companies engaged in qualifying transactions under a framework agreement for intragroup treasury management.
Bulgaria

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 interests 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 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 its 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 the shareholder has influenced the directors in a way that is not in the interests of the company’s creditors.
Directors and shareholders therefore need to be careful that, so far as is possible, 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, the directors may be liable for failing to refuse the parent’s demand, and the parent is liable for making and enforcing the demand.

b) Insolvency process

It should be noted that if a company does become insolvent, the directors must initiate insolvency proceedings within 30 days of the initial date of insolvency. 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 at 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-based companies, both OODs (limited liability companies) and ADs (stock corporations), must observe the following capital maintenance requirements:

(i) 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).

(ii) 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, intra-group loans in a cash pooling arrangement will not be considered a hidden distribution to shareholders and do not fall within this requirement.

(iii) A parent holding company may only:

1. hold cash funds of its subsidiaries if the deposited funds do not exceed three times the registered share capital of that subsidiary; and
2. extend loans to a subsidiary if the aggregate amount of such loans does not exceed ten 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 three 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 be 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.

(i) Risk evaluation before signing the cash pooling agreement
It is important that the directors of the participating companies be 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.

(ii) 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 be 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 company’s participation in the arrangement.
(iii) 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 have 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 include a provision in the agreement that a company experiencing solvency problems is obliged to terminate its participation in the cash pool by repaying all intra-group loans and reclaiming deposited funds. However, this must be done in 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, 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.

(i) 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.

(ii) 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, an individual company’s liability should be restricted, at the very least, to the lesser of:

1. the actual amount of funds withdrawn from the cash pool by that company; and
2. 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.
(iii) 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.

b) Withholding tax
Interest accrued by a Bulgarian company to a foreign company is subject to 10% withholding tax.

Withholding tax may also arise in cases where the cash pooling is used to offset intercompany trade transactions (e.g. payments for services, royalties, etc.), in which case each offset may trigger tax liabilities in Bulgaria as the case may be.

Withholding tax relief may be available under the applicable tax treaty, or domestic rules implementing EU legislation (e.g. relief on intercompany interest and royalties payments). In certain cases a standard advance approval procedure is required to apply the relief.
c) 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 principal or the payment of the interest is not subject to fixed terms;
— the repayment of the principal 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 be 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 be 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.
1. Legal framework for cash pooling

There is no specific legal framework that governs cash pooling in Chile. Even so, Chilean legislation regulates different agreements that share some of the characteristics of a cash pooling arrangement. Also the implementation of this arrangement could trigger different provisions under Chilean law regarding insolvency, banking and corporation laws. In addition, the transactions involved in cash pooling must be allowed by the articles of association of the Chilean company, and in particular they must fall within the company’s purpose as described in those articles. It is then important that the social purpose of the Chilean company allows the company to lend and borrow moneys to and from its affiliates and provide cross guarantees that are normally required in a cash pooling arrangement.

a) Insolvency risks

Cash pooling involves different transactions between a company and a cash pool leader, where we can find an upstream of cash and equivalents to the leader or a downstream to any of the members of this arrangement. It should be borne in mind that due to the nature of such operations, they could potentially adversely affect the liquidity of a participating company to the extent that in the event of being unable to pay its debts, the company could face insolvency. As cash pooling is usually celebrated among related parties, the Chilean Insolvency Law implies some risk for the participants in this arrangement.

The definition of related parties for a Chilean company is given by Article 100 of Law 18.045 on the Securities Market, and includes all its affiliates, its parent company and subsidiaries (the “Related Parties”). This definition is used by the Insolvency Law in order to establish different kinds of limitations when Related Parties act as creditors of an insolvent party.

The Chilean Insolvency Law in Articles 63 and 241 has introduced an exception to title XLI of the Chilean Civil Code that establishes an order of precedence for the payment of creditors of an insolvent party. According to these articles, the credit that a Related Party has with its insolvent debtor, that is not properly documented 90 days before its liquidation order, loses its preference for payment and only gets to be paid when all other creditors have fulfilled their debt obligations. This scenario could be even more difficult, as the law also entitles the liquidator of the insolvent party to delay the payment of the credit of all Related Parties even when properly documented.
The Chilean Insolvency Law has also limited the benefits of related creditors when the debtor has been declared insolvent, depriving them of their right to vote in creditors meetings, and in consequence not being considered for voting quorums.

b) Banking limitation
In Chile, the participation of a Chilean entity in a cash transaction with a non-financial institution is not generally restricted. The main restriction is related to activities which are by law exclusive to banks, regulated in Article 39 of the Chilean General Banking Law. This regulation establishes the prohibition of the provision of banking services to the general public, of accepting their money and providing the public with management and/or financial services.

c) Corporate Organisation
The corporate organisation of Chilean companies is strongly regulated even when it comes to closely held corporations. We can find different limitations and duties that protect the interests of a company and its shareholders. Especially relevant for cash pooling arrangements are Articles 44 and 146 of Law 18.046 on Chilean Corporations, which regulate the transactions between related parties; Article 79 which regulates a minimum amount for payment of dividends; and Article 57 regarding special approvals granted by shareholders.

How deep the impact of these norms is will depend, among others, on the type of legal entities that are going to enter into the agreement, and the amounts involved in it. For example, the implementation of a cash pooling arrangement by a Chilean closely held corporation, when one of its board members occupies the same position in another participant of the cash pool or has an interest in that company, due to the high amounts that this agreement implies, must be previously approved by the board of the Chilean entity or, failing this, by two thirds of its shareholders. This is even stricter when it comes to publicly traded corporations, where all transactions between Related Parties must be previously approved by the board, or failing this, by two thirds of its shareholders.

Also, Chilean law indicates that closely held corporations must pay dividends at the end of each financial year. Publicly traded corporations must pay at least 30% of their annual net profits to their shareholders, and may only avoid this obligation when all shareholders agree to not making a payment. Closely held corporations must attend to what is regulated in their by-laws, and failing this, must attend to the regulations for publicly traded ones. When it comes to cash pool arrangements, it is important to bear in mind that the Chilean participant companies must maintain enough liquidity to comply with this obligation.

Lastly, guarantees for third parties granted by closely held corporations must be previously approved by their shareholders. If the guarantee is for a subsidiary, it can be approved by the board.
2. Liability Risk

a) Shareholders Liability
The general rule under Chilean law is that the shareholders of a closely held corporation and the company are independent entities. Shareholders are only liable for the company obligations up to the amount of their subscribed and paid-up share capital. The same applies to Limited Liability Companies.

However, in the event that following the related parties transaction rules a cash pooling agreement with a related party obtains approval at a shareholders meeting and not only by the board of directors, and such arrangement does not contain the necessary protective provisions to avoid a lack of liquidity situation, the minority shareholders may pursue the responsibility for damages against those majority shareholders, as well as the responsibility of the board members and officers who executed the cash pooling over time.

b) Directors Liability
Article 41 of the Chilean Corporations Law establishes the general liability rule for the board members of a Chilean company. It states that directors of a Chilean company are required to perform their duties with the diligence of a reasonably prudent businessman acting in the best interests of the company, being jointly and severally liable for any harm and damages caused to the entity and its shareholders when acting in a negligent or willful way. A breach of this duty by any member of the board will result in him and the other members being liable to the company, its shareholders and affected third parties for any losses they suffer as a result.

This general rule is replicated in the different provisions and limitations that Chilean law establishes in order to protect the best interests of the companies.

The question of whether a director has performed his duties with the requisite level of diligence must be evaluated solely with regard to the company itself and not with regard to the group as a whole. Therefore, even where a company’s participation in a cash pooling arrangement benefits the group as a whole, the company’s board will incur liability if its members have not fulfilled their duty solely with regard to the company itself. Then special consideration must be given to Article 45 of the Chilean Corporations Law which presumes the guilt of board members that directly or indirectly benefit in a wrongful way from operations that at the same time are harmful to the company. Then there is a certain risk of considering the cash pooling harmful when looked at solely from a company perspective, and if in addition one of the directors has participation in another member of the arrangement, the provision of Article 45 could be triggered.
3. Exchange Control Regulation and Filing Obligations

In the event of the execution of a cash pooling arrangement with foreign entities, regulation under Chapter XII and Chapter XIV of the Compendium of Foreign Exchange Regulations of the Central Bank of Chile should apply. From a practical point of view, this implies different kinds of filings to be performed by the pool leader and/or the Chilean group member when they find themselves in one or more of the following scenarios:

a) The cash pool leader is lending money to the Chilean group member in the Chilean market
If this is the case, it is mandatory that the cash pool leader acts through an entity that is part of the Chilean Formal Exchange Market. The applicable entity must notify the operation to the Central Bank of Chile, filing a form in concordance with Chapter I of the Procedures Manual of the Compendium of Foreign Exchange Regulations.

b) The cash pool leader is lending money to the Chilean group member in a foreign market
In this case, the Chilean group member must notify this circumstance to the Department of Statistical Information of the Central Bank of Chile, indicating:

- Tax Identification Number, Name and Address of the borrower.
- Date of the disbursement.
- Amount.
- Currency.
- Name and country of the lender.
- Time frame of the credit in months.
- Interest rate.
- Destination of the credit.
- Representative of the borrower.

c) The Chilean group member is making a payment to the cash pool leader with money held in Chile
The payment must be done through an entity that is part of the Chilean Formal Exchange Market. This entity must notify the operation to the Central Bank of Chile, filing a form in concordance with Chapter I of the Procedures Manual of the Compendium of Foreign Exchange Regulations.

d) The Chilean group member is making a payment to the cash pool leader with money held in a foreign market
In this case, the Chilean group member, as the borrower, must notify this payment, directly or through an entity that is part of the Chilean Formal Exchange Market, to the Department of Statistical Information of the Central Bank of Chile. To comply with this obligation, the borrower must file the form contained in Annex 2 of Chapter XIV of the Procedures Manual of the Compendium of Foreign Exchange Regulations. This form can be completed and filed online.
e) Operations that exceed USD 1m or the equivalent in other currencies

If any of the prior operations exceeds USD 1m, and notwithstanding the obligations described for each of those cases, the parties involved must also inform the Central Bank directly of the international credit operation, filing the form contained in Annex 4 of Chapter XIV of the Procedures Manual of the Compendium of Foreign Exchange Regulations. This form can be completed and filed online.

f) The Chilean group member makes a deposit from Chile into the cash pool leader account

The deposit must be effected through an entity that is part of the Chilean Formal Exchange Market. This entity must notify the operation to the Central Bank of Chile, filing a Worksheet in concordance with Chapter I of the Procedures Manual of the Compendium of Foreign Exchange Regulations.

g) The Chilean group member makes a deposit into the cash pool leader account with money held in a foreign market

In this case, the Chilean group member must inform the Department of Statistical Information of the Central Bank of Chile directly of this deposit. To comply with this obligation, the borrower must file the form contained in Annex 1 of Chapter XII of the Procedures Manual of the Compendium of Foreign Exchange Regulations. This form can be completed and filed online and must be notified within the ten days following the execution of the deposit.

h) Deposits in foreign markets that exceed USD 5m or the equivalent in other currencies

In the case that the Chilean group member maintains more than USD 5m in deposits in a foreign market, it is obligated to report all the operations executed quarterly to the Department of Macroeconomic Statistics of the Central Bank of Chile. For this purpose, it must file the forms contained in Annex 3.1 and 3.2 of Chapter XII of the Procedures Manual of the Compendium of Foreign Exchange Regulations. This form can be completed and filed online.

4. Tax issues

a) Interest deductibility

Interest on loans would be tax deductible as long as the general legal requirements on deductibility are complied with. If the parties are considered to be related, interest is only deductible when paid and after paying the applicable WHT.

If the interest is paid in benefit of the Chilean company’s foreign shareholder, it may be considered as a deemed dividend subject to ordinary WHT at a 35% rate plus a penalty tax (i.e. a total 45% tax burden). For re-characterisation purposes, the available financial profit, its similarity to the amount loaned, the loan’s repayment term, its extensions, interest rate, among other relevant conditions, must be considered. As an exception, there is no adverse tax consequence as long as the loan is paid in the same year it was granted.
b) Withholding tax
An ordinary 35% WHT rate applies on gross interest paid, remitted or made available abroad.

On the other hand, a 4% WHT rate may apply if the lender qualifies as a foreign bank or foreign financial institution. The latter being a broad concept into which the group’s treasury company or pool leader may fall (the business purpose must be granting loans or financing, and paid-in capital plus reserves must be equivalent to or higher than 200,000 Unidades de Fomento (approx. USD 8m)).

In turn, the Treaty rate is generally set at 15%.

The reduced 4% and 15% WHT rates only apply to interest arising from debt complying with the thin capitalisation rules.

c) Thin capitalisation rules
Excessive indebtedness considers any amount of interest and other loan-related charges exceeding a 3:1 annual total debt-to-equity ratio.

Total debt considers all loans, whether granted in Chile or abroad, and between related parties or not.

The taxable basis considers only related party loans with a WHT rate below 35%.

A 35% sole tax is levied at the level of the Chilean company (which may give credit for the applicable WHT rate paid).

The interest in excess and the sole tax are deductible for tax purposes.

d) Transfer Pricing
Interest rate and loan conditions must comply with local Transfer Pricing Rules, which generally follow the OECD TP Guidelines.

In the case of an audit, the Chilean company is entitled to submit a transfer pricing study supporting the comparability analysis and interest rate determination of its related cross-border transactions.

Moreover, local TP rules provide the alternative to propose an Advance Pricing Agreement to the local tax authority, under which the conditions of the cross-border transaction can be determined and approved a priori during a specific period of time.

Any difference determined by the local tax authority in a TP audit would be subject to a 40% penalty tax and could also be subject to fines.

e) Stamp tax
Foreign loans are generally subject to a Stamp Tax ranging from 0.066% to 0.8% on the principal amount, depending on the maturity date of the loan. Local borrowers are liable for paying the stamp tax on foreign loans.

---

1 Chile currently has tax treaties in force with the following countries: Argentina, Australia, Austria, Belgium, Brazil, Canada, Colombia, China, the Czech Republic, Croatia, Denmark, Ecuador, France, Ireland, Italy, Japan, Malaysia, Mexico, Norway, New Zealand, Paraguay, Peru, Portugal, Russia, South Africa, South Korea, Spain, Sweden, Switzerland, Thailand and the United Kingdom. Treaties with Uruguay and the United States of America are currently signed but are not yet in force – they are awaiting approval before the corresponding Congresses.
China

1. General Legal Framework

In past years, China took a step-by-step approach to liberalise foreign exchange control, but the cross-border inflow and outflow of funds, in particular those under capital account items, are still heavily regulated. Cross-border cash pooling arrangements are subject to the administration and supervision of the State Administration of Foreign Exchange and its local counterparts.

In addition, it is not possible to implement the structure among companies within China where funds are not actually moved and instead the bank offsets the debit and credit balances of the accounts of companies participating in the cash pooling in order to calculate the net interest position of the pool. This is because banks in China are not allowed to engage in such offsetting, i.e. they must charge loan interest and pay deposit interest separately.

2. Arrangement within China

a) RMB Cash Pooling Arrangement within China

There are no specific regulations on renminbi (RMB) cash pooling within China. The banks offer their own RMB cash pooling products for group member companies incorporated in China. All of these products are designed in the form of entrustment loan arrangements via the bank.

Under the *PRC General Provisions of Lending* (the “GPL”), entrustment loans refer to loans for which the funds are provided by an entrusting party. The use of the loans is supervised and the recovery is assisted by the lender (being the entrusted party) in accordance with the purpose, amount, term, interest rate, etc. determined by the entrusting party. The lender (being the entrusted party), i.e. the bank in this context, only receives a handling fee but does not bear the loan risk.

Under such arrangement, one company will act as the “Concentration Leader” which will open a head account with the bank and the other participating companies will also open their own accounts with the same bank. At the closing of each business day, the balances or any funds over a certain value in the accounts of the participating companies will be swept to the head account of the Concentration Leader by way of an entrustment loan. If there is any debit balance in one of the accounts of the participating companies at the end of a business day, the bank is instructed to transfer the amount equaling such debit balance from the head account of the Concentration Leader to the account of the concerned participating company via the entrustment loan arrangement.
b) Foreign Exchange Cash Pooling Arrangement within China

The Provisions on Administration of Centralised Management of Foreign Exchange Funds between Internal Members of Enterprises in China issued by the State Administration of Foreign Exchange (the “SAFE”) on 12 October 2009 (the “Provisions”) allow the eligible members of the group companies incorporated in China to participate in foreign exchange cash pooling through the entrustment loan structure via a bank or the group’s own finance company in China.

Eligible member companies under the Provisions include:
(i) the parent company,
(ii) subsidiaries in which the parent company holds more than 51% of the equity interests,
(iii) companies in which the parent company and the subsidiaries individually or jointly hold more than 20% of the equity interests,
(iv) companies in which the parent company and the subsidiaries individually or jointly hold less than 20% of the equity interests, but the parent company or the subsidiaries or both jointly are the largest shareholder in the companies, and
(v) public institutions or social organisations with legal person status under the parent company and its subsidiaries.

The bank is only allowed to sign the cash pooling agreement with the participating companies if it has received approval from the competent SAFE. However, finance companies do not need to obtain the approval of the SAFE before signing the cash pooling agreement.

c) Direct RMB Loans

Direct inter-company lending is prohibited by the GPL. In the past, any lending between companies in China had to be structured as an entrustment loan arrangement. On 6 August 2015, the PRC Supreme People’s Court promulgated the Provisions on Several Issues concerning the Application of Law in the Trial of Private Lending Cases (the “2015 Provisions”), which for the first time allow direct intercompany loans. Article 11 of the 2015 Provisions stipulates that for contracts concluded between companies for the purpose of production and business operation, where the parties concerned claim that the loan contract is valid, such claim shall be upheld by the People’s Court. Although the GPL is still in place, we consider the risk that the People’s Bank of China may still impose fines on the lender for intercompany loans to be very remote, i.e. nowadays direct intercompany loans are possible.
3. Cross-border Arrangement

a) Cross-border Foreign Exchange Cash Pooling
Under the Administrative Provisions on Centralised Operation and Management of Foreign Exchange Funds by Multinational Corporations issued by the SAFE on 5 August 2015, cross-border foreign exchange cash pooling is possible. One member company of a transnational group company shall act as the concentration leader of the cross-border foreign exchange cash pooling arrangement between the domestic and overseas group member companies. A transnational group company shall mean a consortium linked by capital and comprising the parent company, subsidiaries and other member enterprises or organisations. Before the implementation of the cross-border foreign exchange cash pooling, the consolidated cross-border RMB and foreign exchange payment and receipt amount of domestic member companies in the preceding year shall exceed USD 100m.

A bank in China shall be involved in the cash pooling arrangement. The cross-border foreign exchange cash pooling arrangement shall be filed with the competent SAFE in advance and a recordal notice shall be obtained from the competent SAFE.

b) Cross-border RMB Cash Pooling
Under the Circular on Further Facilitating Cross-border Bilateral Renminbi Capital Pooling by a Transnational Group Company issued by the PBOC on 5 September 2015, cross-border RMB cash pooling is possible. One member company of a transnational group company shall act as the concentration leader of the cross-border RMB cash pooling arrangement among the domestic and overseas group member companies. Before the implementation of the cross-border foreign exchange cash pooling, the aggregate turnover of domestic member companies in the preceding year shall not be less than RMB 1bn and the aggregate turnover of overseas member companies in the preceding year shall not be less than RMB 200m.

A transnational group company shall mean a consortium linked by capital and comprising a parent company, subsidiaries and other member enterprises or organisations, including
(i) the parent company,
(ii) subsidiaries in which the parent company holds more than 51% of the equity interests,
(iii) companies in which the parent company and the subsidiaries individually or jointly hold more than 20% of the equity interests,
(iv) companies in which the parent company and the subsidiaries individually or jointly hold less than 20% of the equity interests, but the parent company or the subsidiaries or both jointly are the largest shareholder in the companies.

An agreement between the group member companies participating in the cash pooling shall be signed with a bank in China. Such bank shall file a recordal of such cash pooling arrangement with the competent branch of the PBOC.
c) Granting Foreign Exchange Loans Abroad

According to the Circular (Hui Fa (2014) No. 2), a PRC entity (except financial institutions) is allowed to grant foreign exchange loans to those offshore companies with which it has an equity relationship. The PRC entity shall apply for registration of such loans with the competent SAFE.

d) Granting RMB Loans Abroad

According to the Circular (Yin Fa (2016) No. 306), a PRC entity can grant RMB loans to its overseas affiliates with which the PRC entity has an equity relationship, i.e. overseas third party borrowers are not allowed.

e) Cap of Loans

According to the Circular (Yin Fa (2016) No. 306), the amount of loans a company in China can grant to its offshore operations can only be up to 30% of its owners’ equity (i.e. net assets). This 30% cap applies to the aggregated amount of both RMB and foreign exchange loans.

4. Liabilities and Restrictions

a) Liabilities of Directors, Supervisors and Senior Management Personnel

Under the PRC Company Law, if a director, supervisor or senior management personnel violates laws, administrative regulations or the company’s articles of association in the course of performing his or her company duties, thereby causing the company to incur a loss, he or she is liable for damages. In the context of the PRC Company Law, senior management personnel refers to a company’s general manager, deputy general manager, financial officer, the secretary to the board of directors of a listed company and other persons specified in the company’s articles of association. Given the above, directors, supervisors and senior management personnel of a company will ensure that setting up the cash pooling arrangement has been duly authorised by all necessary corporate actions of the company and that no other action or proceedings are necessary.

In addition, according to the PRC Enterprise Bankruptcy Law, if a director, supervisor or the senior management personnel of an enterprise commits a breach of his/her obligation of loyalty or obligation of due diligence, thereby causing the enterprise that he/she serves to go bankrupt, he/she will bear civil liability in accordance with the law. Such person may not serve as a director, supervisor or senior management personnel of any enterprise for three years from the date of conclusion of the bankruptcy procedure. Therefore, before entering into the cash pooling arrangement the director, supervisor and the senior management personnel of a company will make an appropriate assessment to reach a conclusion that the benefits of the cash pooling arrangement outweigh any risks and that such an arrangement will not jeopardise the liquidity and solvency of the company. The appropriate assessment will be made in order to avoid being blamed for failure to completely perform his/her due diligence obligation, if the cash pooling arrangement causes a problem with the liquidity or solvency of the company.
5. Tax Issues

b) Restrictions for Listed Companies
Under the Circular (Zheng Jian Fa (2003) No. 56) issued by the China Securities Regulatory Commission and the PRC State-owned Assets Supervision and Administration Commission, a listed company in China is forbidden to lend funds to its majority shareholder and other affiliated parties. Since the cash pooling arrangement is achieved via the entrustment loan structure and the actual lender is not the bank but the participants in the cash pooling, listed companies in China cannot participate in cash pooling with their shareholders and/or affiliated companies.

a) Interest Deductibility
Under the PRC Corporate Income Tax Law, interest on loans is deductible in accordance with the following stipulations:

(i) For loans borrowed from financial institutions by a non-financial institution, the interest is deductible on actual basis;
(ii) For loans borrowed from non-financial institutions by a non-financial institution, the interest is deductible within the limit calculated by reference to the interest rate of a similar loan with the same term as provided by financial institutions.

There are additional limits on interest deductibility where the interest is paid to related parties. The payment of interest to related parties exceeding the thresholds below may be treated as dividend distribution for tax purposes:

(i) such interest exceeds the interest on a similar loan with the same term as borrowed from a financial institution; or
(ii) the total debt from related parties to the equity ratio exceeds 2:1 for a non-financial institution (5:1 for a financial institution), unless sufficient evidence can be provided to prove that such debt arrangement is in line with the arm's length principle (please refer to Section 5 c) below for details).

If the interest payment to related parties is classified as dividend distribution, the relevant interest expenses will become non-deductible for corporate income tax purposes.

b) Withholding Tax
Under the PRC Corporate Income Tax Law, the China-sourced interest income earned by a non-PRC tax resident is subject to 10% withholding tax, unless a double taxation treaty is in place to stipulate a lower tax rate. In that case the tax rate in the relevant treaty prevails.

c) Transfer Pricing and Thin Capitalisation Rules
The interest rates and terms of the intra-group loans are at arm’s length (market basis). Otherwise, a transfer pricing audit might be launched and a special tax adjustment can be made by the PRC tax authorities. Such tax adjustment might cause the non-deductibility of interest expenses of the borrower, if the interest rate exceeds market levels.
In addition, for a non-financial institution, if the total intra-group debt to equity ratio exceeds 2:1, the exceeding portion of interest expenses will be deemed as dividends and cannot be deducted for corporate income tax purposes. The interest expenses refer to the interest, the guarantee fee, the mortgage fee, and other expenses with the nature of interest.

d) VAT and Surcharges
According to the current PRC VAT regulations, the interest income is subject to VAT of 6%. In addition, surcharges are levied on the actual VAT payment which is the difference between the output VAT arising from taxable sales and the input VAT resulting from the purchase of taxable goods or services. However, the input VAT arising from interest payment is not allowed to be credited against the output VAT liabilities. Surcharges might be different from city to city, but generally include city maintenance and construction tax of 7%, 5% or 1% depending on the location, an education surcharge of 3% and a local education surcharge of 2%, each calculated on the basis of VAT paid.

e) Stamp Duty (“SD”)
Under the PRC Provisional Regulations on Stamp Duty, SD of 0.05‰ is levied on the total amount of loan contracts.
1. Legal framework

a) Introduction

Cash pooling is a concept not specifically 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, among others).

Please note that although there are no restrictions for opening a bank account of a Croatian entity with a foreign bank (meaning a bank with its seat outside Croatia), there is an obligation to inform the Croatian National Bank about transactions entered into with non-Croatian entities and foreign account balances.

b) Shareholder loan provisions

As cash pooling is, by definition, always an intra-group loan, legal requirements as to shareholder loans may apply. Certain restrictions as to shareholder loans should therefore be considered. For instance, when a company requires additional equity and instead the shareholder grants a loan to the company, that shareholder loan will (in the event of the company’s insolvency) be subordinated to third-party loans. If the loan is repaid and the Croatian insolvency procedure is initiated against the company within a term of one year of repayment, the shareholder must return the repaid 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 in the cash pool by a subsidiary must therefore not be used by the parent company to obtain further shares in that subsidiary.¹

¹ Although the law explicitly mentions only a joint-stock company (and the purchase of its shares), it is possible that Croatian courts might interpret such provision as applicable to a limited company as well.
b) Granting loans to non-residents
In addition to the aforementioned shareholder loan provisions, cash pooling also triggers a legal requirement set for a Croatian entity granting a loan to a non-resident entity. Namely, according to Croatian law, when granting loan(s) to non-residents, the Croatian entity should obtain from the non-resident the collateral instruments appropriate to ensure the security of a credit transaction. To be more precise, in terms of cash pooling, the respective requirement is triggered by funds being transferred from the regular account held by the Croatian entity to the master account held by the non-resident parent company, which is treated as a loan to a non-resident.

2. Types
Cash pooling may be a) intra-company or b) 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 benefit of the master account.

a) Intra-company cash pooling
It is common in Croatia for big companies to 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 that instance, cash pooling may significantly reduce costs if there are differences between the accounts (i.e. some have net credit positions while others have 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.

---

2 The law does not stipulate which type of collateral instrument is acceptable, i.e. obtaining “simple” collateral (such as a promissory note or bill of exchange) would suffice.
3. Liability risks

a) Directors’ 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, no director should enter into a cash pooling agreement where the company does not receive 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 must 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 benefits 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 event of the insolvency of a subsidiary, a bankruptcy administrator may ask the parent company to repay any amounts received from its subsidiary if there was no shareholders’ decision approving the payment or benefit that would otherwise

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 a 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

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 reasons for entering into the cash pooling agreement, these should be particularly considered in the case of any liability arising from the cash pool agreement.

5. Tax issues

If a company is “thinly capitalised” within the meaning of the Corporate Profit Tax Law, i.e. to the extent that its borrowings exceed its capital more than fourfold, the company will not be able to claim interest paid on the exceeding amount as a tax recognised expense, and will have to pay corporate profit tax on such interest. On the other hand, the interest charged by an affiliated company granting a loan exceeding the allowed threshold will increase the tax base and be taxed at the rate of 12% or 18%.

Furthermore, if interest is not in line with the arm’s length principle, the tax base need to be adjusted, i.e. the company will not be allowed to recognise interest paid as an expense and will have to pay corporate profit tax on it. Such interest may also be considered as the payment of a “hidden” dividend, in which case withholding tax risk may also be triggered.

---

3 12% for companies having total revenue not exceeding HRK 3m and 18% for other companies.
Czech Republic

Cash pooling is not directly regulated under the laws of the Czech Republic as a specific type of financial arrangement. Nevertheless, the generally accepted position is that cash pooling is an intra-group arrangement for the provision of financial accommodation and, as such, is regulated by both the Czech Act on Business Corporations and by local banking and capital markets legislation. The following company and banking law regulations are relevant to cash pooling in the Czech Republic.

1. Company legislation

   a) Lending
   The Act on Business Corporations No. 90 / 2012 Coll (the Act on Business Corporations) which governs the rules for intragroup lending and securing was introduced and effective as of 1 January 2014. Now the provisions are less strict than under the previous legislative framework. In general, there are no restrictions concerning the provision of intragroup loans without a specific purpose under the Act on Business Corporations. There is no longer a need to have a court-appointed expert evaluation with respect to the provision of a loan or security to related parties or members of the companies’ bodies, as was required before 31 December 2013.

   b) Directors’ Liability in relation to Insolvency
   As a general rule, the managing directors of a company must always act with due care and in the interests of the company. If the managing director and his performance lead to the insolvency of the company, he may be disqualified and prohibited from performance of the function of a company’s director for a period of up to three years. In the event that the respective disqualified director breaches the previously levied prohibition, they may receive a further disqualification of up to ten years.

   c) Conflict of Interest
   Rules concerning a conflict of interests may apply in cases where entities influenced or controlled by the same managing director enter into an agreement regarding cash pooling arrangements. In such cases, the managing director is obliged to inform the supervisory or the highest body of the company (i.e. the general meeting in a limited liability company). The supervisory or highest body may then prohibit the company from entering into such an agreement. For this reason it is advisable to obtain the approval of the supervisory body or general meeting/sole shareholder prior to the company’s entry into the cash pooling agreement.
2. Banking legislation

a) Reporting to the Czech National Bank
The Czech legislation stipulates certain reporting obligations of Czech entities towards the Czech National Bank concerning loans with respect to foreign entities or payments abroad. The extent and methods of reporting are subject to separate legislation of the Czech National Bank. The reporting obligation is governed by the Decree of the Czech National Bank No. 235/2013, as amended (the Decree). It only concerns persons that are considered by the Czech National Bank (as the regulatory authority) to be “statistically significant persons”. Persons in this category must be formally informed by the Czech National Bank in order to be subject to the relevant laws. The criteria for placing an entity in the above-mentioned category are set out in the Decree. With respect to received or provided cross border loans, they are set to the threshold of at least CZK 100m in total as at the end of the respective calendar year.

b) Anti-money-laundering requirements
All entities, including participants in a cash pooling arrangement, which accept payments equal to or in excess of EUR 15,000 are required to record the identity of the counterparty and retain that information for a period of ten 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 interests 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 that breach them.

Additionally, since 1 January 2012, committing a property or economic criminal offence may also result in criminal liability for the company itself. The Act on Criminal Liability of Legal Entities and Proceedings against Them penalises illegal acts of all legal entities, which may be subject to fines of up to EUR 60m as well as other sanctions including dissolution of the entity, loss of its business licence and/or the right to trade or the forfeiture of its property.

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

For all Czech entities intending to participate in a cash pooling arrangement the following actions are recommended:

— Approval by the general meeting of shareholders should be obtained for each entity’s entry into the cash pooling arrangement. Provided approval is obtained for the general framework within which the individual loans will be made, only one general shareholders meeting will be needed to approve all of the undocumented loans.

— The articles of association of each Czech entity that will be a party to the arrangements should be reviewed to ensure compliance. This should consider any additional requirements concerning 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.

5. Tax considerations

a) Interest deductibility

Under Czech income tax legislation, all expenses incurred for the purpose of generating, ensuring 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, any interest expenses claimed as a deduction are void and the tax liability is reinstated.

Pursuant to the Czech Income Tax Act No. 586/1992 Coll., costs and expenses concerning related party loans (e.g. interest, fees) are not tax deductible when the aggregate loan amount exceeds the equity of the company 4 times.

Generally, the parties are free to determine a rate of interest that will be charged on loans under the cash pooling arrangement. Regard should be given to thin capitalisation when deciding the rate of interest which should be charged. In addition, 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 assess objectively whether the particular terms of an arrangement comply with the arm’s length requirement, regard may be given to the OECD’s transfer pricing guidelines. The guidelines provide a useful frame-work for setting price valuations by explaining how to apply the arm’s length principle in considerable detail. 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 authorities, confirming that 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 authorities will not issue any retrospective assessment.

b) Withholding tax

Generally, interest and other considerations 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 and it resides in another EU member state; and
— a statement of exemption has been issued by the Czech tax authorities.

The Czech tax authorities will only issue a statement of exemption if they receive the following documentary evidence along with the application:

— notification of a relevant EU tax authority that the foreign company is a 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.
In France, the legal framework in which cash pooling operates consists of rules imposed by banking regulations and by company law.

a) Requirements imposed by banking regulations
At first sight, cash pooling would appear to fall within the activities reserved exclusively for banks in France under the Monetary and Financial Code (Code monétaire et financier). However, section L 511-7, I, point 3 of the Monetary and Financial Code sets out some exceptions to this rule. In particular, the section provides that an enterprise, whatever its nature, may “undertake cash transactions with companies which have with it, directly or indirectly, ties by way of share capital which confer on one of the affiliated enterprises an effective power of control over the others.”

Whilst space does not permit a full analysis of this provision here, disputes in relation to the application of this provision have been rare in recent years.

b) Requirements imposed by company law
Three requirements arising from French company law are usually considered in connection with cash pooling arrangements:

— The first is the requirement relating to corporate capacity. A French company must have the power under its corporate objects to enter into a cash pooling arrangement. In practice, French companies usually have extensive objects, allowing all types of activities. It is therefore difficult to imagine this issue giving rise to litigation in connection with a cash pooling arrangement.

— The second matter to consider is whether the cash pooling agreement requires approval of the company’s board of directors as a “regulated contract” in accordance with section L 225-38 of the Code of Trade (Code de Commerce). This section provides that “every contract entered into directly or through an intermediary between the company and its general manager, one of its delegated general managers, one of its administrators, one of its shareholders holding a proportion of voting rights higher than 10% or, where it is the matter of a shareholder company, the company controlling it within the meaning of section L 233-3, must be subject to the prior consent of the board of directors.”

Only current contracts entered into under “normal requirements” are not subject to this procedure. A cash pooling arrangement will be entered into under normal requirements if the participating companies receive interest at the market rate on cash which they transfer to the pool.
Further, it must be considered whether the cash pooling arrangement qualifies as a current contract. Whilst some case law affirms this, there is still some scope for doubt.

— Finally, it is necessary to ensure that the cash pooling arrangement is in the corporate interest of the participating French companies. This is a matter which must be carefully assessed. The difficulty associated with establishing a corporate interest has been eased by recent case law recognising the concept of a “group interest” (see below).

2. Risks of directors’ liability

There are a number of liabilities which the directors of a French company participating in a cash pooling arrangement should consider:

a) “Abuse of majority” and consequences
A contract can be declared void for “abuse of majority” if it becomes contrary to the interests of such company. This annulment of a decision of a general meeting can give rise to a claim for damages on behalf of the minority shareholders against the directors who originate the operation.

However, it is difficult to find examples in case law of contracts declared void on these grounds.

b) “Abuse of corporate property”
The major risk for directors of French companies participating in a cash pooling arrangement is potential liability for “abuse of corporate property”, i.e. use by the directors of corporate property or funds in bad faith in a way which they know is contrary to the company’s interests. This is a risk which particularly concerns French directors, due to the heavy sanctions which can be imposed – namely imprisonment for up to five years and a fine of up to EUR 375,000.

This raises the question of whether the director of a subsidiary who approves the transfer of funds by such subsidiary to another group entity under a cash pooling scheme is guilty of abuse of corporate property. If only the individual interests of each participating group member are to be considered, the criminal risk is significant since the transfer of funds to another entity is made in the interests of the other participating group companies. On the other hand, the operation may appear perfectly lawful if one takes into account the interests of the group as a whole.

Case law has developed a number of criteria to be considered in this respect. In the well-known Rozenblum case, the French Supreme Court (Chambre Criminelle de la Cour de Cassation) set out three criteria to be considered when deciding whether cash advances between companies within the same group constitute an abuse of corporate property:
— cash advances between companies within the same group must be remunerated with a sufficient rate of interest and permitted within the framework of a policy developed in respect of the group as a whole. However, this must be a genuine group and it is necessary that the group should comply with these requirements in practice;
— it will not suffice that such requirements are only fulfilled “on paper”;
— further, it is essential that any financial detriment incurred by one company for the benefit of another must have been incurred for the economic, corporate and financial interests of the group as a whole, for the purposes of preserving the balance of the group and the continuation of the policy developed for the group as a whole;
— finally, a company cannot incur a financial detriment for the benefit of another if, in incurring such detriment, the existence or the future of such company is threatened.

The French Supreme Court has followed this precedent in all subsequent cases on this matter.

c) Risk of failing to provide market with requisite information
Whilst there is little case law on this point, the Court of Appeal of Paris ruled in a decision dated 2 March 2004 that a cash pooling arrangement could have the effect of masking a state of financial dependence of a subsidiary on its parent company. In the judgment, the court reproaches the director of the subsidiary for having breached its duty to provide exact, precise and sincere information to the public by failing to disclose the true situation.

d) Risk of insolvency and compulsory winding-up
The mixing of funds in a cash pool can cause a risk of uncertainty as regards ownership of such funds and can ultimately lead to insolvency proceedings instigated against one company being extended to other members of the group. Obviously, the existence of a cash pooling arrangement does not automatically result in such uncertainty. Such uncertainty will generally only arise where the flow of funds between participants in the pool is affected by a significant number of unusual transactions or circumstances (for example, default on repayments or debt waiver).

The trend of judges in France, and particularly those of the French Supreme Court, is to set a high standard for compliance in respect of the aforesaid provisions.

3. The reduction of liability risk

Generally speaking, there are three ways in which the risk of liability can be reduced. These include the appropriate choice of a centralising entity, formalisation of the cash pooling arrangement in a written agreement and the observance of certain precautions when drafting the cash pooling agreement.
a) The choice of a centralising entity

There are several options in relation to the choice of centralising entity.

The centralising entity could be the parent company. The disadvantage of this is that the interests of this company may appear excessively enhanced in comparison with the interests of other entities. This solution is likely to significantly strengthen the position of the parent company.

We can also envisage the use of an Economic Interest Grouping, a structure of cooperation which is more egalitarian.

Whatever the choice of centralising entity, the involvement of a bank in the cash pooling arrangement is advisable, since a bank will be able to provide real-time information about the balances on the subaccounts of the various companies participating in the cash pooling arrangement.

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

It is generally considered that, for evidence reasons, the rights and obligations of the companies participating in a cash pooling arrangement should be set out in a written cash pooling agreement. In the absence of a written document, it may be difficult to provide evidence of the participating companies’ respective rights and obligations.

c) Precautions to be taken in relation to written agreements

As mentioned above, the cash pooling agreement must specify that interest is payable to the companies contributing funds to the cash pool.

In addition, a cash pooling agreement should clearly state its duration and include provisions governing the ability of each French company to withdraw from the agreement if participation in the cash pool ceases to be in such company’s interests. Finally, it is important that the circumstances in which a company will become automatically excluded from the cash pooling operations are defined.
1. Legal framework for cash pooling

There is no specific legal framework that governs cash pooling in Germany. The participation of German companies in cash pooling systems entails a range of liability risks both for the directors and the shareholders of the participating companies. This is primarily because in Germany capital maintenance and liquidity protection requirements are relatively strict.

The risk of civil or criminal liability is particularly high when one of the companies participating in a cash pooling arrangement has insufficient liquidity or when certain capital maintenance requirements are not met. Even raising capital and the payment of a loss compensation according a profit and loss agreement entails certain risks for directors and shareholders if the benefiting company takes part in the cash pooling.

The following points might become relevant and therefore should be borne in mind:

a) Care and diligence of a prudent businessman
In general the directors of a German limited liability company ("GmbH") are required by law to apply the care and diligence of a prudent businessman in all matters related to the company (§ 43 sec. 1 German Limited Liability Companies Act ("GmbHG")). The same applies to the board of directors of a joint stock corporation ("AG") according to § 93 sec. 1 sentence 1 German Stock Corporation Act ("AktG"). Therefore the directors must weigh up the chances and risks of cash pooling with the care and diligence of a prudent businessman.

b) Capital maintenance
The pool participants’ directors must observe the principles of capital maintenance (§ 30 GmbHG, § 57 AktG and § 172 sec. 4 German Commercial Code ("HGB") which are relatively strict.

According to these principles, company assets which are required to preserve the share capital must not be distributed to its shareholders or to its shareholders’ affiliates. This would include in particular payments which would cause an adverse balance (Unterbilanz) or which would aggravate an existing adverse balance or over-indebtedness (Überschuldung). An adverse balance is deemed to exist when the company’s assets have fallen to a level below the registered amount of share capital (in the case of a GmbH, the registered share capital must not be below EUR 25,000. In the case of an AG the capital maintenance is even stricter. The registered share capital is at least EUR 50,000 and § 57 AktG doesn’t allow any payments to the shareholder in general and not only if they cause an adverse balance.
If the company has an adverse balance it is only allowed to grant a loan to its shareholder if the reclaimed amount is fully recoverable or if the company has entered into a control or profit and loss transfer agreement with the parent company. If the aforesaid conditions are not fulfilled, in such circumstances (adverse balance or over-indebtedness), payments that are made to a shareholder have to be repaid to the company by the shareholder. The directors who have authorised the payment are liable jointly and severally for repayment and any losses which this causes.

Granting upstream loans (e.g. zero balancing) is considered a payment of this type according to German courts.

In addition to that, the directors of each pool participant might be held liable for all payments made when the company is illiquid or has over-indebtedness (§ 64 sentence 1 GmbHG, § 92 sec. 2 sentence 1 AktG) unless the payments observe the care of a prudent businessman.

c) Liquidity protection
The directors of each pool participant are required to observe the liquidity protection regulations (§ 64 sentence 3 GmbHG; § 92 sec. 2 sentence 3 AktG). This states that directors are personally liable for payments to third parties (e.g. the master account) if the payment caused the company to become insolvent or are made while the company is illiquid or overindebted.

d) Hidden distribution of profits
Profits must only be distributed to shareholders subject to a formal shareholder resolution and in compliance with statutory provisions. Hidden distribution of profits is not allowed. Hidden distribution of profits is deemed to exist whenever the company makes payments or provisions to the shareholders in the absence of an equivalent consideration.

For cash pooling scenarios this indicates interest at usual market rates. An upstream loan may not be granted without interest being paid at usual market rates and, conversely, downstream loans may not be granted at excessively high rates of interest which are inconsistent with normal market rates.

e) Raising capital
The regulations of raising capital may also entail risks. Due to the regulations of raising capital, the initial capital must be rendered so that it is freely and finally at the disposal of the company (“real capital raising”).

This is questionable in the event of incorporation of a new entity or increasing capital of a subsidiary by the parent/treasury company if the initial contribution is paid into a bank account which takes part in the cash-pooling system. Depending on the account balance these cases are treated as follows:
(i) Hidden contribution in kind
If there is a credit balance in favour of the pool leader and the contribution is immediately moved back to the master account, this constitutes a “hidden contribution in kind” (verdeckte Sacheinlage). The initial contribution appears to be used to fulfil a claim. Such a hidden contribution in kind is valid, but the shareholder is still obliged to fulfil its capital contribution, insofar as the value of the received asset is not adequate. It is the obligation of the shareholder to prove adequateness.

(ii) Repayment
If, at the time of the capital raising, there is a net credit balance in favour of the pool participant on the master account, it would be inconsistent with the principle of “real capital raising” for the respective shareholder to make a payment to the pool participant’s pool account and for the amount then to be moved immediately to the master account in the cash sweep. This would constitute a “to-and-fro payment” (“Hin- und Herzahlen”).

In such cases the contribution has only been made validly if the claim against the master account is recoverable and due or becomes due at any time by termination without notice. In addition, the procedure has to be disclosed in the application to the commercial register. If one of these conditions has not been satisfied the shareholder has to fulfil its initial contribution again completely.

Please note that directors may even be held criminally liable when filing the capital raising with the commercial register, if they falsely assert that they are able to dispose of the capital contribution freely and finally.

f) Insolvency proceedings: contestation of transactions and subordination of claims
In cash pooling the risk of the insolvency administrator contesting a detrimental pre-insolvency transaction entered into by a pool participant lies primarily with the pool leader if a pool participant becomes insolvent. The insolvency administrator can contest repayments on shareholder loans which were made during the year before the application for institution of insolvency proceedings without requiring the fulfilment of any other criteria (§§ 129, 135 German Insolvency Code (“InsO”)). The consequence is that in a worst case scenario (all) the amounts paid to the master account as repayments of shareholder loans could be released to the insolvency administrator.

In addition, arising claims of subsidiaries against the parent company from cash pooling are only satisfied subsequently in the insolvency proceedings of the parent company.
2. Liability risks

A breach of the capital maintenance or liquidity protection requirements results in personal liability of the directors, and possibly also the direct, indirect and ultimate shareholders of the companies involved. In contrast to liability for other failure to act in the interests of the company, it is not possible for shareholders to vitiate this liability through a shareholder resolution. The risk of liability becomes particularly significant if one of the participating companies becomes insolvent, or is sold, since it is at this point that an insolvency administrator or the incoming directors of the sold company may pursue such claims.

a) Liability of directors of subsidiaries
The directors of a company are liable for any loss or damage to the company which occurs as a result of their failure to manage the affairs of the company with the care and diligence of a prudent businessman.

In the context of cash pooling, this standard will only be met if the company has taken adequate steps to ensure the repayment of the funds it has contributed to the cash pool. This necessitates termination of the company’s participation in the cash pooling arrangement if there is a risk of insolvency of the parent company or the group as a whole. Even a profit and loss transfer agreement which leads to relaxation of restrictions becomes worthless and cannot avert the director’s liability in such a case of insolvency.

Furthermore, the directors have a specific obligation to compensate the company if, in contravention of the capital maintenance provisions, payments are made which result in a subbalance of the company or if payments are made even though there is a subbalance or the company is illiquid. It is not possible for the shareholders to vitiate this liability in the name of the company, neither through a shareholder resolution nor otherwise. However, shareholders could grant the directors discharge. Discharging the director under certain premises means that the company loses or forfeits its claims against the director under GmbH law. This cannot be achieved under the law governing AGs.

b) Liability of the pool leader and its directors
The pool leader may be held liable for actions which jeopardise the company’s existence if the pool participant becomes insolvent because of its participation in the cash pool. Directors of both the pool leader and the pool participant may be held civilly and criminally liable for having played a contributory role. Such liability is conceivable if, as a result of the cash pooling arrangement, the company no longer has sufficient liquidity to satisfy its obligations to its creditors, for example because the pool leader is also illiquid or just does not allow more drawdowns from the cash pool.
3. Legal structure and reduction of risks

a) Articles of association
First of all it is important to consider whether the shareholders need to pass a resolution to permit the company to take part in the cash pool. Under German law a company can generally take part in a cash pooling system as an extension of the company purpose; this means that it is not necessary to amend the articles of association. Nonetheless it is conceivable that the articles of association or the bylaws of the company call for a shareholder resolution.

b) Facility agreement
In order to reduce the risk of liability associated with a cash pooling arrangement, careful consideration must be given to the rights of the participating companies as regards provision of information and termination (see below). However, given that the law relating to cash pooling in Germany is still being developed, it will not be possible to eliminate all risks entirely.

(i) Right to information
The companies participating in a cash pooling arrangement require continuous up-to-date information relating to the liquidity and equity of the parent/treasury company and the other participating companies if they are to ensure that funds they contribute to the cash pool will be repaid.

The participating companies should therefore agree that the parent/treasury company has to provide the other participating companies with financial statements for the parent company and the group as a whole.

(ii) Right to terminate and to be repaid
The right of a company to terminate the cash pooling arrangement at any time in respect of itself and to be repaid any funds it has provided to the cash pool within 24 hours is of vital importance.

(iii) Option to set off payments for periods against amounts owed under profit and loss transfer agreements
As a result of the most recent case law in this area, it is advisable to agree from the outset that payments made by the parent company to its subsidiaries under the cash pooling arrangement may be set off against any existing (or future) obligation of the parent under any profit and loss transfer agreement to transfer funds to cover losses of the subsidiary. Recently it is discussed, if the payment could be recognized as an advance payment on an existing loss compensation claim. This should be considered carefully.

(iv) Target balancing
To avoid risks of liability, companies should consider conditional- or target-balancing instead of zero-balancing cash pooling. Hereby, a basic amount, in the amount of the share capital, should be kept on a separate account. However, the economical advantages of the cash pooling system are weakened in this type of cash pooling.
(v) Raising capital
A possibility to avoid liability of the directors and to minimise the risk that shareholders will have to fulfil the initial contribution twice when raising capital is to avoid the parent or treasury company and the recipient of the capital being identical. Payments into a bank account with a negative balance should also be avoided.

c) Cash pooling agreements with the individual participating companies and bank agreement
In addition, the agreement(s) entered into by the individual participating companies will need to be back-to-back with the facility agreement if liability is to be avoided.

(i) Termination rights of individual participating companies
Cash pooling arrangements will often envisage that only the parent company may submit valid legal notices to the bank in respect of the cash pooling arrangement. It is important that this general rule does not prevent an individual participating company from terminating the individual cash pooling agreement to which it is party. Moreover, it is important that this termination right is synchronised with a corresponding right of the individual company in the facility agreement to terminate the facility agreement in relation to itself.

(ii) Joint and several liability and security
As a rule, individual cash pooling agreements provide that the participating group companies are jointly and severally liable for any negative balance on the master account and require them to provide security. In addition, the standard terms and conditions used by banks in Germany contain provisions creating liens on all accounts of each of the group’s companies with the bank. If possible, the participating companies should avoid such joint and several liability and security, and should seek an exception from the liencreating provisions of the standard terms and conditions. If this is not possible, the company’s liability should be restricted at the very least to the lesser of (i) the actual amount of funds drawn from the cash pool by the company at any one time and (ii) the amount by which its net assets exceed its minimum required level of share capital as prescribed by law at any one time. The liability of a company should also be fully excluded to the extent that a claim jeopardises the existence of such company.

d) Restructuring of the group
It may be possible to reduce liability risks by restructuring the group (for example, by structuring the group as a conjoined company group consisting only of public companies, by reducing its minimum permitted share capital to the legal minimum level of EUR 25,000 or by merging individual companies).
e) Liability on a sale of a group company

If a company which has participated in a cash pooling arrangement is sold, the seller will usually ask for an indemnity regarding potential liabilities arising from the cash pooling arrangement which the seller and the remaining members of the group may have in respect of the target company.

The buyer will usually request an indemnity in relation to capital maintenance matters, since it will be liable as an incoming shareholder for any payments previously made in contravention of capital maintenance provisions. A seller will usually try to resist such indemnity.

4. Bank supervisory law

Under German law neither the pool leader nor the pool participant require the approval of the banking supervisory authority or an operating licence for a cash pool as long as only affiliates participate in the cash pool.

5. Tax issues

In the case of physical cash pooling, interest may be payable on sums lent and borrowed 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 thin capitalisation issues.
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, Sec. 3.4. 16 of Appendix 3 of Decree No. 51/2016 of the National Bank of Hungary ("HNB") does differentiate between, and thereby accepts, the two concepts of cash pooling noted in the introduction to this brochure: physical cash pooling and virtual (or notional) cash pooling.

In addition, Hungarian banking legislation requires those participating in commercial lending to seek the authorisation of the Hungarian financial services regulator (the HNB), except for financial transactions between a parent company and its subsidiary or between subsidiaries that are carried out jointly in order to ensure liquidity, which 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 HNB 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 by a certain deadline). Alternatively, the company should decide on its transformation into another form of company or on its termination without a legal successor. According to a court decision, if the deadline for providing equity has passed, the shareholders can only decide on the transformation or termination of the company (i.e. the company cannot be “saved” by providing equity at this stage).

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 limited liability company (Kft) has fallen to or 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 will be a risk of invalid distribution.

c) Liability

As a general rule, the directors of a company involved in cash pooling must ensure that the company does not fall into insolvency owing to 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:

d) Piercing of the corporate veil

If a limited liability company or company limited by shares is terminated without a legal successor, a shareholder cannot rely on its limited liability if it has misused such protection and unsettled creditor claims remained because of this, and the same applies if a shareholder holding at least 75% of the voting rights conducts, as shareholder, a business policy that is permanently disadvantageous to the company and the termination without legal succession was due to such business policy (this does not apply in the case of ordinary, voluntary winding-up). Therefore, the shareholders of a company may have joint, several and unlimited liability for the unsatisfied debts of their company. Additionally, a sole shareholder or a shareholder holding at least 75% of the voting rights is liable without limitation for the debtor’s unsettled debts, if the court establishes the unlimited and full liability of this shareholder due to a business policy that is permanently disadvantageous to the company pursuant to a claim filed during the liquidation proceedings or within 90 days after the closure of liquidation proceedings.

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 from a subsidiary, leaving it without liquidity and forcing it into insolvency.

An additional type of piercing of the corporate veil liability relates to the transfer of shares in bad faith. If the debtor has an amount of debt outstanding which exceeds 50% of the registered capital of the company, the court may declare that the former majority shareholder who transferred his shares within three years of the commencement of the liquidation proceedings is liable without limitation for the debtor’s unsettled debts, except when the former shareholder is able to prove that at the time of transferring his shares the debtor had still been solvent, the accumulation of debt has only happened after, or, even though the debtor was threatened with insolvency or was insolvent, the shareholder has acted in good faith and considered the interests of the creditors during the transfer.
A situation where the liability of a majority shareholder is applied in a similar way to the above is the forced annulment of a company, when the court annuls the company notwithstanding that the company left behind unpaid debt.

**e) Directors’ liability for damages**
Under Hungarian company law, directors of a company are liable to the company for any damage it suffers as a result of the directors’ activity under the rules of breach of contract. The damage that a company may suffer includes damage suffered directly by the company, or damage caused by the directors 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 should seek the 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 the breach was caused by a circumstance falling outside of his/her controlling scope, not foreseeable, and it could not have been expected that the director would avoid the circumstance or prevent the loss or damage.

**f) Directors’ liability for debts**
If a situation occurs that threatens the solvency of a company, the directors must perform their obligations taking into consideration the interests of the creditors of the company (arguably, the interests of the company should also be considered, although this is not clear from the law). 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). Directors may also be held liable under the Hungarian non-contractual liability regime if the company is terminated without a legal successor, there are unsettled creditor claims and the directors did not take into account the interests of the creditors after a situation threatening insolvency has occurred.

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 corporate tax purposes.

The debt applicable for this purpose includes – inter alia – 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 authorities as long as the loan serves the business purposes of the taxpayer.

c) Corporate Income 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 9%.

d) Transfer pricing rules
If the pool members are considered related parties for corporate income tax purposes, the following transfer pricing requirements must be observed by the Hungarian pool members:

— notifying the Hungarian tax authorities of related party transactions within 15 days of entering into a contractual arrangement for the first time; and
— maintaining sufficient documentation of the related party transactions,
— applying arm’s length prices or adjusting the corporate income tax base to reflect the situation as if market prices and market conditions had been applied.

e) 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 this issue be clarified with a Hungarian tax professional prior to setting up a cash pooling structure.
f) Financial transaction tax

Financial transaction tax is applicable from 1 January 2013 on various financial transactions. Such financial transaction tax applies – inter alia – to all wire transfers, at a rate of 0.3% of the transaction value, with an upper limit of HUF 6,000 (EUR 21) per transaction. The tax is payable by the financial institution, which can then pass the cost on to its clients. Although cash pooling transactions seem to be exempt from the financial transaction tax provided that all participants keep their accounts at the same bank, a careful analysis of the details of each cash pooling arrangement is required to determine whether any elements of the cash pooling structure may actually still be subject to the tax.
Italy

Although there are no specific provisions governing cash pooling schemes under Italian law, a cash pooling arrangement could trigger the application of Italian corporate law provisions on capital maintenance, financial assistance, inter-company loans and group “direction and coordination” activities.

1. Corporate objects and benefit, financial assistance and recovery of funds

Every transaction which an Italian company enters into must be permitted by the company’s articles of association and, in particular, must fall within the company’s object as set out in the articles of association. It is therefore important that the object of the Italian company allows the company to lend and borrow monies to and from its affiliates and provide the cross-guarantees often required in connection with a cash pooling arrangement.

In addition, Italian law prevents an Italian company from entering into an agreement for the provision of any kind of financial support to its parent company or another company in its group (including the provision of guarantees to third parties in respect of obligations of such other company) unless it receives some kind of consideration in return or it can be reasonably expected that it would gain some other direct or indirect benefit from the transaction. As such, a company joining a cash pooling arrangement cannot contribute funds to the cash pool or grant a guarantee or security over its assets in connection with such arrangement (including over its commercial accounts receivable) unless it has an – even indirect – interest in doing so. If the company does not have such an interest, this may result in:

— the company’s directors being liable to the company, its shareholders and its creditors for any damage or loss they may suffer; and
— the relevant agreement(s) being declared void.

It should also be noted that where an Italian company contributes funds or provides guarantees or has obligations which are in some way connected to the financing or the repayment of debts incurred for the acquisition of the shares in such company, then such contribution or guarantee and any connected security granted may constitute financial assistance in contravention of Article 2358 of the Italian Civil Code and as a result may be declared void unless, in the case of an Italian joint stock company (S.p.A.), certain specific circumstances occur (whitewashing procedure).
Finally, it should also be noted that if the Italian participating company contributes funds to the cash pool (rather than simply benefiting from contributions made by other participating companies), the cash pooling agreement between the participating group companies must enable the Italian participating company to terminate the agreement and easily and promptly recover funds transferred to the various other participating companies (or the cash pooler) thereunder.

As a result of the above, the directors and the members of the board of internal auditors ("Collegio Sindacale") of the Italian participating company must carefully consider:

a) whether the company has an interest (direct or indirect) in entering into the cash pooling arrangement and in providing any connected guarantee; and
b) the circumstances in which, and conditions on which, the relevant arrangements can be entered into.

Directors who have even a potential conflict of interest in the cash pooling arrangement (e.g. directors who sit on the board of more than one participating company) must disclose this conflict and refrain from voting at the relevant board meeting of the Italian participating company.

2. Capital maintenance rules

A cash pooling arrangement could also trigger the application of Italian corporate law provisions on capital maintenance.

Particularly relevant here are Articles 2467 and 2497 quinquies of the Italian Civil Code, which relate to loans granted to an Italian company by its shareholder(s)/controlling company. These provisions apply when either:

a) with regard to the type of business undertaken by the Italian borrowing company, the debt-to-equity ratio of that company appears unbalanced; or
b) the financial condition of the Italian borrowing company is such as to require a capital contribution.

If either of the above circumstances applies:

— the rights of the shareholder(s)/controlling entity to repayment of such loans will rank behind claims of any other creditors of the Italian borrowing company; and
— if the Italian borrowing company goes insolvent, any repayment made in respect of such loans by the Italian borrowing company in the year preceding the declaration of insolvency will be automatically revoked and any sum received by the lender must be repaid by the lender to the liquidator of the Italian borrowing company.
In the context of cash pooling, therefore, if the Italian participating company is subject to enforcement, liquidation or insolvency proceedings, and one of the conditions under a) or b) above applies, the rights of any shareholder(s)/controlling entity of the Italian company to repayment of funds provided to the Italian company under the cash pooling arrangement will rank behind the other debts of the Italian company and, in the case of insolvency of the Italian company, all repayments made by the Italian company to its shareholder(s)/controlling entity under the cash pooling arrangement in the previous year must be repaid to the liquidator.

Although there are no precedents on this matter, it is generally considered that “shareholders” in this context means direct shareholders of the company and that therefore the above requirements do not apply to loans granted to the Italian company by persons/entities who have only an indirect shareholding in the company and who do not exercise any control over it.

3. Rules restricting companies’ indebtedness for creditor protection purposes

Although there are no specific rules restricting companies’ indebtedness, directors of Italian companies have a specific duty to preserve the company’s assets and to refrain from entering into transactions that may adversely affect the financial situation of the company or its assets.

In light of this, the directors of an Italian company must carefully evaluate all possible consequences of the company’s participation in a cash pooling arrangement in order to ensure that they comply with this duty.

In particular, the directors must consider – with reference to the contractual structure of the cash pooling arrangement – the extent of the risk that the Italian company will be unable to recover sums it contributes to the cash pool or directly to the other participating companies (e.g. in the case of insolvency of the cash pooler or of the relevant participating companies).

In order to mitigate such risk it is common practice to limit to a certain amount (target balance) the sums made available by Italian companies in the cash pooling system. Other solutions (e.g. the provision of security by third parties, such as banks or third-party companies) may also be adopted in order to limit the risk that the Italian company becomes unable to meet its obligations where funds it contributed to the cash pooling system become irrecoverable.
4. Direction and coordination

Under the provisions of Article 2497 et seq. of the Italian Civil Code, if a controlling company “induces” (i.e. forces, procures, causes, etc.) an Italian subsidiary to enter into a transaction that is not in the best interests of that subsidiary, then the controlling company and any other person (legal or natural) involved in the transaction could be jointly liable towards the creditors of the subsidiary for any loss such creditors suffer as a result of the transaction.

In addition, any persons who benefited from, or took advantage of, the transaction may be liable to indemnify the creditors of the subsidiary, although only to the extent of the advantage or benefit they derived from such transaction. In other words, the rules of the Italian Civil Code referred to above may enable the creditors of the Italian subsidiary to bring a claim against any group entity that participated in or benefited from the transaction, if such transaction is contrary to the Italian subsidiary’s interests and capable of causing loss to its creditors. In considering whether any other group entity benefited from the transaction it will frequently be necessary to consider the manner in which any surplus in the master account is used (for example, it might be invested) and the criteria on the basis of which the participating companies benefit from that surplus. It should also be noted that the decision to enter into a cash pooling agreement is normally taken by the board of directors, which must consider all implications of the transaction for the company on the above matters. In any event, where the board of directors of a subsidiary passes a resolution approving certain action to be taken by that subsidiary which is wholly or partly for the benefit of one of its controlling companies, the resolution must set out in detail reasons and benefits which justify the decision taken and must analyse the relevant pros and cons (Article 2497ter of the Italian Civil Code).

Requirements also exist in relation to information to be disclosed in the explanatory notes to the annual accounts and the directors’ report.

Finally, if the Italian company is owned by a sole shareholder, any agreement between the company and this shareholder will be unenforceable vis-à-vis the company’s creditors unless minutes exist of the meeting of the board of directors at which the agreement was approved or the agreement bears a date which is certain at law (e.g. the agreement has been executed and dated before a notary or bears a post office date stamp) and such date precedes the commencement of enforcement proceedings against the company.
5. Filing obligations

According to the recent clarifications by the Bank of Italy, the management of cash liquidity among companies belonging to the same group which is effected through a pooler acting with the mere purpose of optimising the management of group liquidity cannot be considered as a payment service according to the provisions of Directive 2007/64/EC (to be repealed by Directive 2015/2366 starting from 1 January 2018), and therefore no authorisation/communication is required to act as pooler of the group cash pooling system. Such exemption is granted on the assumption that liquidity management is limited to the group companies and no transfer of funds is effected to third parties not belonging to the group.

With the purpose of surveying and drafting the relevant statistical reports on the international transfer of money, the Bank of Italy established the so-called “direct reporting” system which is based on the data entered by certain companies, periodically selected by the Bank of Italy, which are requested to provide information concerning transactions, international investment positions and non-financial transactions, together with certain details relating to participating companies.

Any transfer of money effected under the cash pooling arrangements through Italian banks or financial intermediaries is subject to reporting by the relevant banks or financial intermediaries. The threshold triggering the relevant reporting duties amounts to EUR 15,000.
Luxembourg

Cash pooling is not governed by a specific legal framework and is common practice in Luxembourg.

The general principles of company law and certain tax aspects must be considered. Cash pooling is also subject to banking regulatory law and criminal law. While issues such as withholding tax, thin capitalisation rules, tax rates, incentives and transfer pricing are relevant, Luxembourg’s advanced tax clearance system guarantees the tax treatment of transactions up front.

1. Corporate interest

Under Luxembourg law, a company’s executives, i.e. its managers or directors, must exercise their function in accordance with the corporate interests of their company to avoid any risk of being held personally liable. The entry into a transaction is generally in the corporate interest of a company when it derives a direct benefit from it.

In the absence of any such direct benefit, the corporate interest of a single company entering into such transaction could be justified by the “group interest” of the group of companies it belongs to.

As there is no specific law governing groups of companies, the general legal regime applies. Each company has thus to be considered as a single entity following its own corporate interest. Indeed, a court would likely assess whether the “group interest” which a company is supporting is (still) in line with the “corporate interest” of the company, as compliance with the latter is decisive when assessing the lawful management of the company. A certain contractual balance in intra-group transactions must therefore be maintained.

In the absence of case law regarding the interest of groups of companies, the following cumulative elements taken from considerations derived from the prevailing doctrine can be considered as decisive when assessing if a transaction, which is in the “group interest”, is also within the scope of the corporate interest of a company:

a) there is a common benefit to the parties involved in the light of the group policy, including a direct or indirect economic advantage for the company;
b) the risks of the transaction should be evenly apportioned among the concerned group’s companies; and
c) the transaction should not exceed the supporting company’s financial capacity.
When a group company enters into a cash pooling system and becomes a pool participant, its corporate interest shall not only be respected at that moment, but it must also be able to leave the cash pool at any time during the process if a situation arises where its corporate interest starts to get affected – namely when another pool participant or the pool leader gets into economic difficulties, meaning the pool participant sees the recoverability of its claims endangered and/or may no longer access the master account if needed to stay solvent itself. In order to exercise the termination right validly, each pool participant must have access to information on the financial situation of the pool leader and, if possible, of the other pool participants.

If the transaction is not found to be (any longer) in the corporate interest of the company, its directors/managers may be liable towards the company insofar as the entry into the transaction or its undue prolongation could be considered a management fault. Furthermore, in the event of infringement of the Luxembourg Act of 10 August 1915 on Commercial Companies, as amended ("Companies Act"), or of the articles of association of the company, their liability towards the company and third parties may be grounded in special liability provisions of the Companies Act. Finally, general tort liability rules may also apply, for instance if the general duty of due care and diligence or a provision imposing a specific obligation of a non-contractual nature, is infringed. It should be understood that in all the above cases, third parties must, as plaintiffs, establish a fault, the damage suffered and a causal link between the fault and the damage.

The absence of a corporate interest may also lead to criminal liability of the directors/managers or de facto directors/managers of the company for having made use of the assets or credit of the company in a manner which they knew was contrary to its interests for personal reasons, or for the benefit of another company in which they are directly or indirectly interested – the mere fact that a transaction is contrary to the corporate interest of the company does not, however, per se entail criminal liability of the management.

2.
Capital maintenance rules

No distribution to shareholders or financial assistance to a third party may be granted if it results in a reduction of the assets of the company below statutory capital and the legal and statutory reserve. However, such circumstance may occur in certain cases permitted by law, such as investment companies with fixed capital or certain public limited liability companies.

3.
Corporate object

The articles of association state the purpose of the company and may limit the authority of the company’s executives. The company and its executives carry out activities within the scope of the company’s purpose. Any action outside the scope of the company’s purpose cannot be undertaken and, if it is undertaken, would trigger the executives’ liability towards the company and third parties.
Circular issued by the Luxembourg direct tax authorities

Circular L.I.R. 56/1 – 56bis/1 of 27 December 2016 (the “Circular”) addresses most of the issues concerning the tax treatment of companies carrying out intra-group financing transactions.

Under the Circular, an intra-group financing activity consists for a Luxembourg resident company in granting interest-bearing loans or advances to related enterprises, refinanced by financial means and instruments such as public debt issuance, private loans, advances or bank loans.

The Circular also states that if a transaction between related parties does not have a commercial rationale (i.e. if independent parties would not have entered into the transaction), that transaction may be disregarded along with the related tax implications.

The Circular provides guidelines regarding the requirements an intra-group financing company must perform to determine arm’s length prices. This notably includes comparability, a functional and a risk analysis:

a) **Comparability analysis**
   (i) The comparability analysis is based on two main elements:
   (ii) the identification of the commercial or financial relations between associated enterprises and the determination of the conditions and relevant economic circumstances attached to these.

b) **the comparison with comparable transactions between independent parties.**

c) **Functional analysis**
   The functional analysis aims to identify the relevant economic activities, responsibilities and functions, assets used or provided and the risks borne by the parties related to a financing transaction.

d) **Risk analysis**
   Intra-group financing companies should have the financial capacity to assume and to manage the risks they have to bear, the same way that financial institutions would in an open market.

Furthermore, the company should have the adequate level of equity (to be determined based on a risk analysis) and substance, evidencing that the managers have adequate decision-making and risk monitoring capabilities.

It is possible to obtain an advance pricing agreement (which request should disclose the key elements of the transaction) with the Luxembourg tax authorities.

Based on current Luxembourg legislation, provided that compliance with arm’s length principles is ensured, interest expenses incurred by a Luxembourg entity within a cash-pooling arrangement should be tax deductible for Luxembourg income tax purposes and should not be impacted by any Luxembourg withholding tax.
The Netherlands

1. Legal issues associated with cash pooling

No specific statutory framework exists under Dutch law in relation to cash pooling, nor has cash pooling given rise to discussion in case law. The rules applicable to cash pooling are based on generally applicable provisions of the Dutch Civil Code ("DCC"). The following provides an overview of the provisions of the DCC that may affect cash pooling in the Netherlands. Furthermore, an overview is provided of certain regulatory aspects. Our overview has been limited to the civil law framework and as such does not extend to taxation, finance and insolvency matters relating to cash pooling (with the exception of a brief discussion of the fraudulent conveyance proceeding (actio Pauliana)).

a) Corporate objects / ultra vires
The authority of the board of directors of a Netherlands company (the Board) is limited by the corporate objects set out in the company’s articles of association. Contracts entered into by the Board which are outside the scope of the company’s objects (i.e. ultra vires) may be rendered void by the company (or by the company’s trustee in the case of insolvency) if it can be established that the contractual partner was aware, or should reasonably have been aware (without making any further enquiry), that the contract was ultra vires.¹

In general, the fact that a company’s articles of association have been filed with the commercial register will not automatically result in constructive awareness of their content by the contractual party. However, case law suggests that financial institutions may, under certain circumstances, be under a stricter obligation to inquire whether a transaction falls outside the scope of the company’s objects², for example where a financial institution grants a credit facility to a corporate group (or to a part of such group). In light of this, financial institutions will usually verify the articles of association of the companies involved in a cash pooling arrangement prior to entering into such an arrangement.

One of the objections raised against cash pooling (particularly zero-balancing arrangements) in the Netherlands is that the companies involved potentially worsen their financial positions by giving up their financial independence and that therefore such arrangements may be outside the scope of a company’s objects. Even where, in the context of a cash pooling arrangement, a parent company grants a loan to a subsidiary to enable the subsidiary to pay its creditors (thus benefiting such subsidiary), it cannot be ruled out that the parent company will be acting outside the scope of its objects.

¹ Note that the other party to the contract does not have a right to claim that the contract was ultra vires; this is an exclusive right of the company.
² Court of Appeal of Amsterdam, 22 March 1984, NJ 1985, 219 (Nesolas) and 27 November 1986, 1987, 801 (Credit Lyonnais Bank).
However, in 2003, the Supreme Court of the Netherlands ruled that a credit facility provided to an ultimate parent company by a third party for the purposes of supporting the activities of the group will generally be considered to be for the benefit of all companies within the group. ³

On the basis of this ruling, it can be argued that if the cash pooling arrangement serves to support the activities within the group, all the companies involved can be deemed to benefit from it (even if it is a zero-balancing arrangement) and therefore even if the companies relinquish a certain amount of financial independence in connection with it, it does not necessarily conflict with the corporate objects of the relevant companies. In establishing whether the Board’s actions are ultra vires, all circumstances (e.g. commercial and factual matters) must be taken into account – it is not sufficient to simply look at the wording of the corporate objects clause in the articles of association.

If, under the cash pooling arrangement, intra-group guarantees are given (with or without security) by the participating companies, it is necessary to ensure that (i) the company concerned derives a corporate benefit from the obligation of the third party in respect of which the guarantee is provided⁴, and (ii) such company’s existence is not threatened by the provision of such guarantee. In general, a company will be deemed to benefit from the provision of such guarantee if a strong financial and commercial interdependence exists between the company and the other group members and the company’s existence is not foreseeably endangered by allowing the bank such recourse.

If, and to the extent that, there appears to be an imbalance between the commercial benefit gained by the company and the detriment it would suffer if the guarantee were called upon, the company (or its insolvency trustee) will be able to contest the guarantee’s validity. This is the case irrespective of the wording of the objects clause in the articles of association.

It should be noted, however, that there is no unanimous view in Dutch legal doctrine as to the type or extent of benefit required. Therefore, it cannot be ruled out that even if there is the strong financial and commercial interdependence referred to above, a transaction might be declared void by the Dutch courts if it is evident that the transaction cannot serve the realisation of the company’s objects.

In light of the above, it is always advisable to include wording in the recitals of the cash pooling agreement which explicitly refers to the economic and commercial benefits for the company in entering into the agreement.

³ Supreme Court, 18 April 2003, JOR 2003/160.
b) Conflict of interest

A conflict of interest can arise if individuals sit on the Board of more than one of the group companies participating in a cash pooling arrangement.\(^5\)

Dutch law provides that in the event of a conflict of interest between the company and the members of its Board, the company may be represented by the supervisory board\(^6\), unless the articles of association provide otherwise\(^7\). Alternatively, the general meeting of shareholders has the power at all times to appoint a person to represent the company in the event that a conflict of interest occurs.

In practice, the articles of association would usually provide that if a company enters into a transaction with another company in its group, the members of the Board remain authorised to represent the company (this does not affect the right of the shareholders to appoint an alternative company representative). Under the DCC, conflict of interest rules intend to prevent a board member, in the performance of his duties, from being led by his personal interests instead of the interests of the company which he is obliged to serve.\(^8\) Pursuant to Dutch case law, a contravention of the rules regarding conflict of interest will lead to the underlying transaction being voidable at the instigation of the company (or its insolvency trustee). The Supreme Court of the Netherlands has ruled that there is a conflict of interest if a member of the Board cannot safeguard the interests of the company concerned completely and objectively.\(^9\)

It is therefore prudent to arrange for the general meeting of shareholders of the participating Dutch company to specifically appoint a representative of the company for the purposes of entering into cash pooling arrangements. This representative may also be a member of the Board.

c) Capitalisation requirements

Under the DCC, a Dutch company may only make distributions to the extent that its “equity capital” (i.e. share capital, share premium and reserves) exceeds the aggregate of its paid-up share capital and its reserves, which in turn must be maintained according to the statutory requirements and any requirements contained in the articles of association of the company. A resolution in respect of a distribution which is adopted by the general meeting of shareholders of the company or its Board in breach of these requirements may be void or voidable.

However, if monies transferred at the end of each business day are construed as a loan under a cash pooling arrangement rather than a distribution of profits, these conditions do not apply.

---

5 In general, a conflict of interest can occur if (i) a company enters into a transaction with a member of the Board or with a party in relation to whom a Board member has a specific interest (“personal” conflict of interest); (ii) a member of the Board is the parent company and both companies enter into a transaction with a third party; or (iii) a member of the Board acts on behalf of several parties to an agreement in its capacity as a Board member (“qualitative” conflict of interest).

6 Under Netherlands law, the general role of the supervisory board is to supervise the company’s management and the course of the company’s business, generally.

7 Article 2:146/256 DCC.

8 Supreme Court, 21 March 2008, JOR 2008, 124 (NSI).

9 Supreme Court, 29 June 2007, C06/041 HR.
d) Fraudulent conveyance proceedings (actio Pauliana)
It could be argued that cash pooling arrangements are detrimental to creditors of the companies involved, since where credit and debit balances of all participating companies are consolidated, the company will no longer receive any interest on any credit balance it might otherwise have had. The creditors of the company (or its insolvency trustee) could annul such a cash pooling arrangement if they can demonstrate that this arrangement constitutes a fraudulent act within the meaning of Article 3:45 DCC. Under this article, a legal action is fraudulent if the debtor performed an act without an obligation to do so and knew or should have known that this act would be detrimental to its creditors. Any creditor of the company can then challenge the validity of such legal action, irrespective of whether such creditor’s claim arose before or after the legal act was performed.

However, if other arrangements are made between the group companies to compensate the companies with a credit balance, it could be argued that the cash pooling arrangement is not detrimental to the creditors of such companies.

e) Regulatory aspects
After the introduction of the Capital Requirements Regulation (Regulation (EU) No. 575/2013, “CRR”) on 1 January 2014 a debate has arisen in the Netherlands as to the permissibility of utilising notional cash pooling schemes that are to be eligible for capital relief under the CRR provisions for the bank involved in the cash pooling. The Dutch Central Bank takes the view that the customary set-off provisions of banking law applicable prior to 1 January 2014 (permitting an offsetting of positions held within a group of businesses, and where credit and debit positions exist between different counterparties belonging to the same group) are no longer permissible under the CRR provisions. Therefore notional cash pooling schemes are no longer resulting in capital relief for banks established in the Netherlands, as the banks are not permitted to apply the “netting” rules of Article 196 CRR et seq. in notional cash pooling systems.

Cash pooling systems that are structured by including actual cash sweeps (on a daily basis) from one account to other accounts may still remain to be eligible for the purposes of capital requirements and relief from such requirements.

2. Board liability

Under the DCC, the Board of a company involved in an intra-group cash pooling arrangement is, in principle, under an obligation to avoid insolvency of that company.

a) Mismanagement
Under the DCC, each member of the Board has the duty to act in accordance with certain principles of fair management. Non-compliance with these principles may constitute contravention of the corporate objects of the company if such non-compliance results in a serious loss to the company’s creditors. This will constitute mismanagement if it can be demonstrated that no other reasonable and rational director would have acted in a similar manner.
In addition, various legal authors hold the view that zero-balancing arrangements may under certain circumstances constitute mismanagement by the Board of the company. If a company becomes insolvent due to a lack of sufficient funds as a result of a zero-balancing arrangement, members of the Board can be held personally liable.

b) Tort
The trustee of a company in insolvency can, in exceptional circumstances, hold the Board liable on the basis of tort (“onrechtmatige daad”) to the extent that the company has insufficient funds to satisfy the claims of its creditors. Such exceptional circumstances would include a situation in which the Board knew or reasonably could have known that the solvency of the company would be seriously affected by the transfer of liquidity to the cash pool at the end of each business day. This reasoning is mainly based on the general principle of independence of the Board of a company. Under this principle, the Board must ultimately be able to justify any actions it takes which may affect or threaten the existence of the company. The company’s participation in a cash pooling arrangement could be justified by the benefit such an arrangement provides to the group as a whole and thereby to the individual participating companies. The Board of the participating company will have to assess continuously whether or not the cash pooling arrangement threatens the solvency of the company.

3. Liability of the parent company

In exceptional circumstances, the parent company, as holder of the master account, may be liable to make payments in respect of sums owed to creditors of a participating subsidiary, on the grounds that such parent company has received funds from the participating subsidiary which would otherwise have been available to satisfy the claims of creditors. If payments made by the participating subsidiary to its parent company on an ongoing basis under the cash pooling arrangement could be expected to adversely affect the rights of such subsidiary’s creditors, the parent company may have to take actions to avoid or limit the extent of such consequences (including but not limited to filing for insolvency). The contravention of this obligation could lead to liability of the ultimate parent company (or the participating company’s shareholder, as applicable) on the basis of tort.

Generally, however, the courts rarely find a parent company liable in tort on these grounds and the situations in which liability has been established are typically situations in which the parent company was closely involved in the management of its subsidiary company or affected the rights of that company’s creditors.  

Finally, it should be noted that even where the Board/parent company is found liable on one of the grounds described in sections 2 and 3, this does not affect the validity or the enforceability of the cash pooling arrangement itself.

In Peru there is no specific law or regulation for cash pooling. While Peruvian companies are not prohibited from entering into cash pool agreements – likely to be governed by foreign law – there are certain matters of Peruvian law that should be considered.

1. Banking regulation

a) Permitting
Cash pooling services are not included in the list of authorised activities of the Peruvian Banking Law. Moreover, no specific regulations regarding cash pooling have been issued. Therefore, Peruvian banks will require a special permit from the Peruvian Superintendence of Banking, Insurance and Pension Funds Management (“SBS”) in order to provide cash pooling services.

Additionally, the funds flows between the treasury company and the companies of its group may have similarities with intercompany loans. According to the Peruvian Banking Law, only companies supervised by the SBS are entitled to perform financial intermediation activities. Financial intermediation consists in fund-raising from the public on a regular basis by any method or manner and the placing or lending to the public of the funds raised on a regular basis by any of the authorised banking transactions listed in the Peruvian Banking Law. In our view, entering into cash pooling structures is not a breach of Peruvian banking law. This is because no financial intermediation services are rendered to the public. On the contrary, the structures only extend to the members of their economic group. Nevertheless, please note that the SBS is vested with the authority to (i) determine if any business is performing banking transactions without the corresponding permits, (ii) order the closing of its offices, and (iii) file a claim for criminal liability. It is therefore possible that the SBS may investigate the activities of a company entering into cash pooling structures to determine if financial intermediation services are performed without authorisation.

b) Anti-money-laundering regulation
It is likely that the transfers to be made in the cash pooling structures are equal or above the thresholds that trigger registering unusual transaction duties and reporting suspicious transaction duties of Peruvian banks. Registering duties are triggered when transactions are above USD 2,500 for a single funds transfer and USD 10,000 for multiple funds transfer. The SBS may require the register of unusual transactions for its assessment. Reporting suspicious transaction duties is triggered if the transaction, its amount or periodicity has no relation to the company corporate object or economic grounds. Hence, it is advisable
that Peruvian companies enter into cash pool agreements in order to support their transfer or transactions with the treasury company in order to avoid liability.

2. Corporate issues

a) Corporate object and representatives’ liability

It is not mandatory to include cash pooling activities or intercompany loans in the corporate object of the companies, whether they manage the cash pool account or provide the funds for it. However, representatives (whether directors, officers, executives or attorneys) can be liable to the company if they enter into an agreement whose terms and conditions exceed the corporate object of the company. While the agreement will be valid and therefore binding between the company and third parties, the representatives will be liable to the company. Hence, it is advisable to obtain the corresponding corporate authorisation (i.e. from the shareholders or board of directors, as applicable) to execute the cash pooling agreements and provide the corresponding powers of attorney to its representatives.

b) Net worth thresholds and limited liability protection

In certain circumstances, the balance sheet of companies with regard to cash pooling structures may be affected in a way that breaches the thresholds established by the Peruvian Corporations Act, so as to lose its limited liability benefits. On the one hand, the Peruvian Corporations Act establishes a mandatory winding-up of a company whose net worth decreases below one third (33.33%) of its capital stock. On the other hand, a Peruvian company whose assets are not enough to cover liabilities has to be submitted to bankruptcy proceedings. In both cases, the company loses its limited liability benefits until shareholders reverse such a situation (i.e. by increasing the capital stock or paying the company’s debts). Consequently, in this context, whoever acts on behalf of the company during such situation (directors, officers, executives or attorneys) will be jointly liable with the company. If this happens, it is important to (i) issue a communication to shareholders according to the terms established by the Peruvian Corporations Act so they can decide on the steps to follow, and (ii) communicate to top executives the importance of not entering into any agreement until such situation is solved.

3. Bankruptcy

Peruvian bankruptcy law has no regulation regarding cash pooling agreements or structures. Notwithstanding, bankruptcy proceedings – which may result in the liquidation or restructuring of a company – handled by the Peruvian Bankruptcy Authority (“INDECOPI”) could affect its effectiveness.

a) Unenforceability of debts

From the publication date of the proceedings, all the debts of the company accrued before that publication date will become unenforceable (“Bankruptcy Claims”). Creditors with Bankruptcy Claims need to file their proof of claim in order to be allowed to participate in the proceedings. An automatic stay is therefore installed.
If a Peruvian company which is part of the cash pooling structure enters into bankruptcy proceedings, its share to be paid to the pool will become unenforceable and the treasury company will have to file its proof of claim before INDECOPI in order to be allowed to vote and collect according to Peruvian bankruptcy rules. Please note that if the company is subject to liquidation proceedings or its assets are sold under reorganisation proceedings, the payment of the debts will be subject to the bankruptcy priority order (labour claims, secured claims if collateral has been granted before the foregoing publication, tax claims, and unsecured claims).

b) **Nullity of actions taken by the Peruvian company**

Any creditor or the new managers of a Peruvian company subject to bankruptcy proceedings could request the courts to declare null and void any action taken by the debtor (i) during the previous year, and (ii) from that date on until the date the creditors’ board ratifies or replaces the management of the company; provided, however, that such actions affect the Peruvian company’s net worth.

### 4. Tax

There are no specific tax rules or case law regarding cash pooling structures. However, the Peruvian Tax Authority (“SUNAT”) could consider cash pooling deposits and withdrawals as intercompany loans and hence tax them as applicable. It is mandatory to comply with the arm’s length rules to avoid tax adjustments from SUNAT and fines.

**a) Income Tax – Transfer Pricing Rules (“TP Rules”)**

TP Rules apply to both deposits to be made by the Peruvian company to the treasury company’s account (passive interest rate) and withdrawals to be made by the Peruvian Company from the treasury company’s account (active interest rate) under the cash pooling structure, as applicable. On the one hand, the corresponding passive interest rates will be included in its annual income tax returns. On the other, the corresponding active interest rates are subject to 30% income tax withholding rate. Please note that a Peruvian company will be jointly liable with the treasury company regarding the tax applied to the cash pooling withdrawals.

**b) Deductible expenses**

Expenses related to interest arising from intercompany loans are deductible for income tax purposes only when the amount of debt does not exceed the result of applying a coefficient of 3 on the taxpayer’s net equity on the previous year (Related Company Debt to Equity ratio (3:1)). The interest related to the proportion of the loan that is in excess of the foregoing ratio cannot therefore be recognised as a deductible expense.

---

1 Tax regulations establish a different criterion in order to determine if certain parties are related (i.e. to be considered related a company will own more than 30% of the capital stock of another company). The applicable income tax rate for non-related parties is 4.99% (to the extent that other requirements are complied with).
Please note that – as a general rule – the expenses of transactions made with companies or permanent establishments incorporated in tax havens are not deductible. However, the expenses related to such transactions could be exceptionally deducted if the interest rates are established according to the arm’s length principle.

c) *Value Added Tax (“VAT”)*

Deposits and withdrawals to be made by a Peruvian company could qualify as credit services.

On the one hand, SUNAT will apply VAT (18% rate) to such withdrawals (to the extent that the credit service is provided by a non-domiciled company but is used within the country by a Peruvian company). The Peruvian company will be considered as the taxpayer.

On the other hand, deposits to be made by the Peruvian company will be considered as “export of services” provided by the Peruvian company and hence no VAT will be applicable since the service is not used in Peru. Therefore, passive interest rates will not be subject to VAT.

There are different cash pooling structures (i.e. notional cash pooling). According to their specific terms, this may have different tax consequences.
Poland

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. There are therefore 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 interests of a company, but at the same time profitable for the company’s shareholders or capital group of companies, as long as the rules considered below, among 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 provided liquidity to the other participants).

The other key risks surrounding insolvency are that:

— The company’s insolvency is declared. Although such a declaration does not, generally speaking, cause the termination of a cash pooling agreement, the insolvency trustee/administrator may terminate the agreement or the agreement may be subject to other restrictions and limitations arising under Polish insolvency law, such as hardening periods.
— 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 benefit to the other participants, the creditors may demand that such actions be declared ineffective.
If a company declares insolvency, a loan being granted by a shareholder to the company is in the last category of receivables to be satisfied from the bankruptcy estate, which determines the order of its satisfaction.

If a company encounters financial difficulties, the management board must immediately convene a shareholders’ meeting in order to decide on the future existence of the company (when the balance sheet shows a loss exceeding the aggregated supplementary and reserve capitals, and half of the share capital) or apply to the relevant court for the declaration of the company’s bankruptcy (if the company fails either or both of the two insolvency tests applicable under Polish law). Otherwise they are threatened with personal civil and criminal liability for not filing for bankruptcy in due time. They may, however, discharge themselves from responsibility in this respect, in particular if they prove that, within the time limit provided for filing the bankruptcy petition, the restructuring proceedings were opened or an arrangement in the course of such proceedings regarding the approval of arrangement was accepted.

It should also be noted that a cash pooling arrangement may cause a violation of Polish capital maintenance rules (see paragraph (b) below for details). 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; or
— returning any payments from a company’s assets to the shareholders (to the extent such assets are necessary to cover the company’s share capital).

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 only receive a return from their contributions, or the assets of the company, after a share capital decrease or 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, do 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 civilly or criminally liable. 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 a person holding such office, and to avoid any situations that may lead to the company's insolvency. Their actions should therefore 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 risks of damage to the company against any benefit it may gain; 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.

As a general rule, the above liability must not be excluded or limited; in particular, the board must 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-based 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 generally 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.

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 completely exempt from those reporting obligations).
4. Tax issues

Cash pooling arrangements are not specifically regulated under Polish tax law. It is advisable to apply for an individual ruling to avoid a dispute with the tax authorities. The most sensitive tax areas related to cash pooling are the following:

**Withholding tax**
Interest paid abroad is subject to 20% withholding tax. Interest paid by a Polish entity into a foreign cash pool will therefore be subject to withholding tax. The tax can be reduced (even to zero) by the relevant taxation 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 European Parents-Subsidiary Directive, which has been fully implemented into Polish law. Under certain conditions mentioned in the Polish Corporate Income Tax Act, there is a possibility to apply for such an exemption.

**Thin capitalisation**
Interest paid to:
(i) a company owning directly or indirectly at least 25% of the shares of the borrower; or
(ii) a company where a common shareholder owns directly or indirectly at least 25% of the shares in both companies (qualifying lenders), is subject to thin capitalisation rules.

Under these rules, interest paid by qualifying lenders which exceeds the amount of the borrower’s equity does not constitute a tax-deductible cost, in the proportion in which the amount of debt exceeding the amount of the borrower’s equity remains to the total amount of the debt to the lenders.

**Transfer pricing documentation**
Since 1 January 2017, significant changes in Transfer pricing regulations have come into effect, regarding, among others, cash pooling agreements. It is therefore recommended that the agreement’s provisions be verified every time if cash pooling documentation is required.

In general, transfer pricing documentation should be prepared if the transaction value exceeds the transactional threshold.

**VAT**
Cash pooling agreements on the grounds of the Value Added Tax Act are usually subject to VAT, but under specific provisions in the cash pooling agreements they could be exempted from taxation.
Tax on Civil Law Transactions

In principle, a cash pooling agreement understood as a complex financial liquidity agreement should not be subject to tax on civil law transactions.

However, specific provisions in the agreement could generate tax liabilities.
Portugal

1. Legal overview

There are no specific laws governing cash pooling activities in Portugal. As far as we are aware, no judicial decisions on cash pooling have been handed down so far. Instead, one must look to various areas of Portuguese law (in particular, banking, corporate and insolvency law) in order to establish the parameters within which cash pooling may operate.

2. Banking law requirements

In Portugal, cash pooling arrangements are permitted among companies which are in a group or control relationship pursuant to the Portuguese Companies Law (PCL) even if they are not financial institutions. In fact, the benefit of cash pooling is that it is an exception to the rules governing the granting of credit as an activity reserved exclusively for financial institutions. In general, no special authorisation needs to be obtained by any of the entities participating in the cash pooling arrangement (other than the bank).

For this purpose, companies are in a group relationship where the whole share capital of one company is entirely owned by the other, either directly or indirectly. A control relationship is established if one company holds the majority of the voting rights correspondent to the share capital of another company or, in general, whenever the former is able to exert a dominant influence over the latter. On the other hand, it should be noted that cash pooling arrangements are admissible either between Portuguese companies and Portuguese and non-resident companies which are in a group or control relationship. However, Portuguese residents must notify the Bank of Portugal (BoP) of any accounts which they open abroad as well as provide information concerning payments and receipts in relation to such accounts. Also, the financing of a Portuguese resident by means of funds made available by a non-resident must be declared to the BoP.

3. Corporate issues

a) Corporate object

There are few corporate law limitations on cash pooling arrangements. Cash pooling activities need not be listed as a specific corporate object in the articles of association of the company in order for the company to lawfully engage in such activities. Instead, they are treated as an ancillary activity, undertaken in order to further the main objects of the company (in the same way as lending money, granting security and giving guarantees). However, this type
of structure must not be used for purposes of financial assistance (a target company must not provide funds or a guarantee with the aim of acquiring its own share capital).

b) Capacity
In general terms, cash pooling arrangements do not conflict with the best interests of the companies involved and in fact the individual interests of each company should prevail over the interests of the remaining companies participating in the arrangement.

However, in the case of companies which are in a group relationship pursuant to the PCL, disadvantageous instructions regarding, for instance, the execution of cash pooling agreements, may be issued by the managing company to the subordinated company if such instructions serve the interests of the managing company or of other companies in the same group.

c) Capital maintenance rules
Generally, cash pooling arrangements do not directly impact on the net equity of the participating companies and instead have an impact on the companies’ liquidity. Notwithstanding, if one or more companies participating in the scheme face financial difficulties, the remaining companies may be confronted with a reduction in their net equity.

If the net assets of a company fall to a level below half its share capital as per the accounts of the company, the directors should immediately request the convening of a shareholders’ meeting in which shareholders are required to take appropriate measures such as the winding-up of the company, a share capital reduction to reflect the net assets of the company or the execution of capital contributions by the shareholders in order to reinforce the net equity of the company.

Portuguese law does not generally limit the amount of debt which a company can assume (unless certain thin capitalisation rules apply). The amount a Portuguese company may borrow by way of a bond issue is limited to the compliance by the company, following the bond issue, with a financial autonomy ratio greater than or equal to 35% (such ratio being the percentage resulting from the equity/net assets).

d) Directors’ liability
In general, directors of a Portuguese company are required to perform their duties with the diligence of a reasonably prudent businessman acting in the best interests of the company. A breach of such duty by directors will result in them being liable on a joint and several basis to the company, the company’s shareholders and its creditors for any losses they suffer as a result. The directors will be in breach of their duty if, for example, they enter into a cash pooling agreement on terms which may adversely affect the company, or if they fail to withdraw from the cash pooling arrangement when the financial viability of the rest of the group deteriorates to such an extent that the company may not be able to recover sums it has contributed.
The directors may also incur liability if they fail to convene a shareholders’ meeting in circumstances where the net assets of the company fall to a level below half its share capital or if they fail to apply for a declaration of insolvency when it becomes legally mandatory. In such circumstances, they may become jointly and severally liable for any debts of the company. This is in addition to any liability the directors may face on other grounds connected with the company’s insolvency.

The liability of directors to the company and its shareholders is excluded if and when the act or omission causing losses is determined by a shareholders’ resolution, even if such resolution may be annulled. This exclusion does not apply as far as liability towards creditors of the company is concerned.

Directors may incur criminal liability if they cause the insolvency of the company as a result of the violation of their general management duties with serious negligence.

e) Parent companies’ liability
Parent companies may be liable for obligations undertaken by companies they wholly own even though the companies which are in a group relationship are domiciled in different jurisdictions.

4. Insolvency law

Portuguese insolvency law does not specifically cover cash pooling agreements or arrangements. However, the opening of insolvency proceedings results in specific effects on certain ongoing contracts. Management agreements and current account agreements must be terminated upon the opening of insolvency proceedings.

The administrator appointed to the proceedings will be able to claim repayment of loans that the insolvent cash pool member may have made to the cash pool arranger.

Claims against the insolvent cash pool member will be filed with the administrator and be subject to subordination should the lender be considered a person or company with a special relationship to the borrower, i.e. a company which is or has in the past two years prior to the filing of insolvency proceedings been in a group or domain relationship with the borrower, or if the credit is considered to arise from a shareholder loan. In such case, the subordinated creditor would only be able to collect any portion of its credit after full redemption of privileged and common credit by the insolvent estate.

Acts carried out by the insolvent company to the detriment of the estate are subject to voidance and clawback by the administrator in the two years prior to the filing for insolvency. Maliciousness is assumed if the other party is a person or company in a special relationship with the insolvent. Redemptions of a shareholder’s loan made within one year prior to the filing for insolvency are also voidable by the administrator.
5. Tax law

a) General remark
From a tax perspective, Portugal does not have a specific tax regime applicable to cash pooling structures per se. As such, we will address the main implications that should be taken into consideration in Portugal upon implementation of cash pooling arrangements or solutions, as the matter is approached in Portugal, i.e. granting credit and payment of interest.

b) Granting credit – Portuguese stamp duty implications
The use of credit in Portugal or granted to Portuguese companies will trigger Portuguese stamp duty at rates which vary in accordance with the term of the credit/loan being granted. For cash pooling structures, the stamp duty is assessed per month, on the monthly average computed as the sum of total daily debtor balances during the month, divided by thirty, at a 0.04% rate.

Portuguese tax legislation sets out an exemption on short-term loans (granted for less than 1 year) in order to cover specific treasury needs. Such exemption applies both to (i) short-term loans granted by the shareholder to the subsidiary in which share capital is held in at least 10% (to be held or kept for at least 1 year) or, if less, with the acquisition price of such stake being not lower than EUR 5m, as well as (ii) to short-term loans granted by a subsidiary to its shareholder which owns at least 50% of the share capital.

Notwithstanding the above, the Portuguese tax authorities’ perspective, which follows a literal interpretation of the provisions of the stamp duty code, is that the exemption is not applicable to short-term loans (to cover treasury needs) whenever the user/borrower is a non-resident entity. On the other hand, it only applies to short-term loans granted (i) between Portuguese resident entities or (ii) to short-term loans involving an EU entity or an entity resident in a country with which Portugal has a Double Taxation Treaty (“DTT”) in force, but only when the non-resident entity assumes the position of creditor.

c) Portuguese withholding tax (WHT) implications on payment of interest
(i) Domestic regime
As a general rule, and according to the Portuguese CIT Code, interest due by Portuguese tax residents to non-resident entities is liable to a 25% withholding tax rate.

(ii) EU regime
Under the EC Directive 2003/49/CE, as adopted by Portugal, no withholding tax will be due in Portugal on interest due to affiliated companies, provided that the conditions required for its application are met. For this purpose, an affiliated company is defined as follows:

(1) If it holds a direct participation of at least 25% in the registered share capital of the other company; or
(2) If the other company holds a direct shareholding of at least 25% in its registered share capital; or
(3) When a third company holds a direct participation of at least 25% of the registered share capital of two entities, which makes them affiliated among themselves.
In all cases, the required 25% direct shareholding is required to have been held for a period of at least two consecutive years prior to the WHT obligation. If the required 2-year period is completed after the WHT obligation, the beneficiary will be able to apply for a full reimbursement of the tax withheld.

(iii) Tax treaty regime
Under the Portuguese Tax Treaties network, interest paid by a Portuguese resident entity to an eligible tax treaty entity is subject to reduced withholding tax rates of between 10% and 15%. Application of the reduced withholding tax rates on an upfront basis requires the completion of certain formal requirements aimed at certifying the eligibility of the beneficiary for the tax treaty protection provisions.

d) Tax deduction of interest costs
Interest costs are generally deductible for Portuguese CIT purposes, as long as they are deemed necessary to generate the company’s taxable profits and provided they are duly documented. However, the Portuguese CIT Code sets out a specific interest barrier rule, under which net interest expenses will only be tax deductible up to the higher of the following thresholds:

- EUR 1m; or
- 30% of the EBITDA.

The net interest expenses that were not deducted, for having exceeded the limits mentioned, can be carried forward over 5 FYs, as long as together with the interest expenses of such FY they do not exceed the said limits. Additionally, whenever the EBITDA threshold (the EUR million threshold is not relevant for this purpose) is not reached in a given FY, the amounts that were not used will be added to this limit for the following 5 FYs, until its effective utilisation.

e) Transfer pricing aspects
Cash pooling and current accounts put in place between affiliated companies are subject to Portuguese transfer pricing regulations, which follow OECD standards and guidelines.

f) VAT aspects
Finance transactions, including cash pooling arrangements and current accounts, are VAT-exempt.
Romania

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

(i) 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 intra-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, potentially corporate criminal liability and up to three years’ imprisonment for the directors.

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.
(ii) 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. intra-group cash pool lending, for a period exceeding one year), must notify the NBR's statistics department of such arrangements within 30 days of the date of signing.

b) Corporate law
(i) 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, i.e. 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 sanctions for the company's directors). However, in practice, it is debatable whether companies carrying out cash pooling activities, and thus intra-group loans, are required to include in their scope of activity the specific business activity with respect to lending. This is due to the fact that it is not clear whether the scope of activity with respect to lending applies also to intra-group loans, which are considered as not carried out on a professional basis, or only to lending activities carried on a professional basis by credit institutions and non-banking financial institutions supervised by the NBR.

(ii) Capital maintenance rules
The registered share capital of Romanian companies must meet the minimum amount required under Romanian law. If the board of directors becomes 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 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.

(iii) 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 two 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.

(iv) 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 in 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, whereas a violation of law may result in tortious (civil) or criminal liability.
(i) Criminal liability
Generally speaking, a director of a company may be imprisoned for up to three years if, in bad faith, he uses the assets of the company for a purpose contrary to the company’s interests, 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 interests of the cash pool group should prevail over the individual interests of each company participating. It therefore appears that, to the extent an intra-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 intra-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.

(ii) 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: (1) providing false information to a parent company; (2) paying or receiving dividends resulting from false profits or profits which cannot be distributed; (3) fraudulent management; and (4) possession of cash without registering it in the accounting records.

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

(i) 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.

(ii) 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 interests.

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 be paid to the guarantor (by the guaranteed) in consideration of giving the guarantee. Since giving such a guarantee in exchange for a 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 be checked in this respect.

4. Tax issues

Cash pooling structures are not specifically regulated under the Romanian tax legislation. However, from a domestic tax perspective, transactions carried out based on cash pooling arrangements are considered to have a financing nature. While, as a general principle, a cash pooling scheme could be contractually structured between the parties, from a tax perspective the transactions carried out pursuant to the cash pooling contract should be specifically analysed on a case by case basis and depending on the excess/shortfall position of the relevant party.

a) Corporate income tax implications

(i) Creditor (excess position)
Interest earned by Romanian companies is included in the taxable profits and subject to a 16% corporate income tax. Similarly, any net foreign exchange gain is taxable and any net foreign exchange loss is deductible.
(ii) Debtor (shortfall position)
Under the general tax deductibility rule, expenses (including interest expenses) are deductible if incurred for business purposes. However, the deductibility of interest expenses is subject to the thin capitalisation rules (as described below), unless the interest expenses relate to a cash pooling arrangement in which the cash pool leader is a Romanian or foreign bank, or a non-banking financial institution, in which case such interest expenses are fully deductible and not subject to such thin capitalisation rules. In relation to cash pooling arrangements in which the cash pool leader is not a financial institution, the deductibility of the interest expenses is subject to the following thin capitalisation rules:

— “Safe harbour rule” – Romanian companies can deduct interest expenses, up to a maximum amount calculated based on the NBR’s reference interest rate (currently 1.75%) in relation to loans denominated in the Romanian currency (RON), or the annual interest rate (currently 4%) in relation to loans denominated in a currency other than RON. Any interest exceeding this maximum amount is permanently not deductible for corporate income tax purposes.
— “Debt-to-equity ratio” – The deductibility of interest expenses related to financing granted for a period of more than one year is subject to limitations based on the debt-to-equity ratio. Interest expenses and net foreign exchange losses are fully deductible if the debt-to-equity ratio is positive and lower than or equal to 3:1. Otherwise, the interest expenses and net foreign exchange losses are not deductible, but can be carried forward to future periods when the debt-to-equity ratio is met.

b) Withholding tax implications
Romanian payers of income (interest, commission or service fees, depending on the specific type of cash pool arrangement) have to withhold 16% tax of the gross payments. However, this withholding rate may be decreased or even eliminated under double taxation treaties (the “DTT”) concluded by Romania (as of 1 January 2017, Romania concluded 87 DTT) or the EU Interest and Royalties Directive (the “Directive”).

In order to claim the benefit of the DTT, an original valid certificate of tax residence must be provided by the income beneficiary valid for the year in which the interest payments are made.

Similarly, in order to claim the benefits of the Directive, a valid certificate of tax residence must be provided by the income beneficiary, together with an affidavit attesting that the requirements under the Directive have been met.

Separately, please note that EU/EEA resident income beneficiaries may choose to adjust the domestic withholding tax through assessment on a net basis (i.e. by deducting costs related to the financing), subject to compliance with the relevant tax procedure.
c) Transfer pricing

Transactions concluded between related parties must comply with the arm’s length principle (i.e. the price of the transaction must be set at the market value). Although not specifically regulated by the Romanian transfer pricing legislation, the lending and borrowing under a cash pool mechanism can be classified as lending (crediting) operations. Therefore, irrespective of the position of the entities participating in the cash pool mechanism (i.e. excess cash and cash shortfall position), the actions taken as part of the cash pool mechanism should be viewed as crediting (lending) operations and the related interest rates should reflect the market interest rates applicable to loans.

Separately, Romanian companies may be obligated to prepare a local transfer pricing file, depending on various factors (e.g. the taxpayer’s category (large, medium-sized or small), the applicable materiality thresholds (based on the annual value of the inter-company transactions) and the type of transaction (financial transactions, supply of services or purchases)).
In Russia, cash pooling is still a relatively new concept, having become commonplace only recently. There is no unified legislation governing cash pooling arrangements and the legal framework in which cash pooling operates consists of general civil and insolvency law provisions, as well as banking and tax law regulations.

1. Legal framework for cash pooling


2. Form of agreements for cash pooling

Russian banks provide their clients with “physical” (also known as “zero-balancing” or “target-balancing”) and “notional” cash pooling services. The cash pooling arrangements largely depend on whether the participants are separate legal entities interested in the group liquidity position or just the head office and regional branches regulating the company’s liquidity, whether there are only Russian participants in the structure or both Russian and foreign entities, and whether foreign currency is involved.

From our experience, the majority of the cases in which Russian banks are involved are physical cash pooling arrangements, with several participants being the Russian companies of the same group, in roubles, which are based on intra-group loans. Such a cash pooling structure is usually operated under the following terms and conditions:
The master account, together with the accounts of the group members, is to be opened and maintained in a single bank in roubles. In practice, the master account is normally opened by the parent company.

Each group company enters into an intra-group loan agreement (or agreements) with the parent company. Each such intra-group loan agreement stipulates the possibility of loans being provided by the parent company to a subsidiary and/or vice versa.

The intra-group loans are to be provided on an arm’s length basis, i.e. interest is to be paid at the market rate and the principal amount is repayable.

The parent company may also enter into a master loan agreement with the bank. Under the terms of such a master loan agreement the bank will, among other things, make a facility available to the parent company, including by way of an overdraft in respect of the parent company’s bank account.

Russian banks usually require a guarantee or other security (direct debit mechanism) from the foreign holding company of the parent company or the parent company itself in order to secure repayment under the master loan agreement.

The cash pooling structure and mechanics are sometimes set out in a separate cash pooling agreement which all participants and the bank are parties to.

Operations on bank accounts (including labelling transfers and set-offs) are carried out by the bank using the Russian direct debit and standing instructions mechanics, to the extent permitted by applicable law and banking rules.

The bank’s client identification and anti-money laundering rules are to be complied with.

1 Accounts in foreign currency are also possible; however, this should be analysed in relation to each specific structure. Generally, transfers and payments in foreign currency between Russian entities are not allowed (save for a limited number of instances) and, therefore, foreign currency accounts are more relevant when there is a foreign entity or entities (or its representative offices and branches) participating in a cash pooling structure.

2 It should be noted that if one of the group companies is a non-resident, the currency control rules apply. Accordingly, a Russian company will have to open a transaction passport in respect of a potential loan with the bank if the general amount of the potential loan between the Russian company and non-resident company exceeds USD 50,000 (or its equivalent in any other currency), and comply with other reporting requirements while carrying out operations with respect to such loan, which adds a substantial administrative burden.
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 who influences the activities or decision-making of the subsidiary.

b) Liability of the management bodies
Under the Federal Law “On Limited Liability Companies” (the “LLC Law”) and Federal Law “On Joint Stock Companies” (the “JSC Law”), members of the board of directors (supervisory board), the general director (sole executive body) and members of the management board (collective 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, they may be liable for such loss (unless otherwise stipulated in Russian legislation).

Like the parent company (see above), members of the management bodies and other persons authorised to control the activities of the company may also be liable for losses of an insolvent company if the insolvency was caused by their actions (e.g. making a decision to use cash pooling services) or if it was 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 jointly liable.

Members of management 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 the event of insolvency).

An example of how liability could arise in a cash pooling arrangement is where the general 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 general director.
c) Liability of banks
In addition to the liability risks facing companies participating in cash pooling, 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 regulation of the Central Bank, the latter may fine the relevant bank up to 0.1% of the banks’ minimum charter capital (set out by the Central Bank), 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 apply other measures culminating in the revocation of the bank’s licence, thus leading to its liquidation.

4.
Measures to reduce the risk

a) Viable structure of cash pooling
Any potential cash pooling structure should be properly analysed from a legal and tax standpoint in order to develop a viable cash pooling structure for a particular company or group of companies, as well as its structure and residence and business needs.

b) Corporate approval issues
According to the LLC Law and JSC Law, certain transactions of a company must be approved as major transactions. Additionally, in accordance with the recent legislative amendments which came into force on 1 January 2017, so-called “interested party transactions” (e.g. transactions that may involve affiliates or cross-management) may require a corporate approval if the management of the company or a shareholder holding at least 1 per cent in the capital requests that the relevant transaction be subject to approval. However, the company’s charter may envisage different rules for corporate approvals of “interested party transactions” or require an approval for other types of transactions. Failure to obtain the necessary corporate approvals required either by law or the company’s charter may serve as grounds for invalidating such transactions.

The charter of the company should therefore be carefully checked before any transaction, in order to identify and comply with all necessary corporate approval requirements.

c) Right to terminate the cash pooling arrangement
Companies participating in a cash pooling arrangement should reserve the right to immediately terminate (and ensure that the legal documentation allows them to do so) 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.
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. For the purpose of interest deductibility, the interest rate under the loan should lie within the following interval (from 1 January 2016):

- for loans in RUB – from 75% up to 125% of the Central Bank’s key rate;¹
- for loans in EUR – from EURIBOR in EUR + 4 up to EURIBOR in EUR + 7;
- for loans in USD – from EURIBOR in USD + 4 up to EURIBOR in USD + 7.

If the interest rate under the loan does not fall within the intervals above, the borrower should apply transfer pricing rules in order to prove the market level of the interest.

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.

Recent court practice confirmed that it is possible to use cash pool arrangements, subject to a taxpayer providing the tax authorities with evidence of its economic substance and transparency of transactions. Please note, however, that the case relates to intra-group loans and does not deal with other forms of cash pooling.

¹ The key rate of the Central Bank is currently 10% per annum.
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 Serbia) is subject to prior approval from the National Bank of Serbia (NBS), which can be granted only for a limited number of cases listed under the NBS bylaws. In addition, foreign exchange regulations impose limits both in terms of granting and receiving loans from abroad, allowing 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 Serbia, or a foreign bank, may not be feasible.

b) Banking legislation
Pursuant to Serbian banking law, the following activities:

(i) accepting deposits,
(ii) the granting of loans
(iii) and issuance of payment cards, 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, up to ten 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

(i) Duty of care / conflict of interest
Shareholders of the company who (solely or acting in concert with third parties) hold a minimum of 25% of voting shares, as well as shareholders who have control over the company, the supervisory board, the managing board and any persons engaged in the management or representation of the company, procurators, liquidation managers, owe a general duty of care and loyalty to the company and are subject to corresponding liability for breach of these duties. Shareholders and directors are primarily required to perform their duties 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 shareholders and of the company’s duly diligent directors (the same applies to all other persons subject to the duty of care) is to prevent the company from becoming insolvent. Consequently, the concern of the shareholders and directors is that an inherent risk in cash pooling is the insolvency of one participant threatening the solvency of all other participants. In addition, certain transactions undertaken by a company up to five 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 directors 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 shareholders who are subject to the duty of care and the company’s directors seek professional advice from reputable financial advisors prior to having the company enter into the cash pooling arrangement.

Transactions between a company and its shareholders who are subject to the duty of care or other persons that are subject to the duty of care (or their related persons) are deemed to be “transactions involving a personal interest”. Transactions involving a conflict of interest require the approval of the competent corporate body. Failure to comply with this requirement will render the cash pooling agreement between the conflicting parties null and void.

However, if in court proceedings it can be proved that the agreement, entered into without the appropriate approval of non-conflicted board members/ shareholders, is beneficial (to the company), 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.
(ii) Capital maintenance rules

The registered share capital of Serbian companies must meet the minimum amount required under the Serbian Companies Act (under the general rules – less than EUR 1 for a limited liability company and approx. EUR 25,000 for a joint stock company). 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 stipulates that the company cannot make distributions to the company shareholders if:

(1) the company’s net assets are or would fall below
   (a) its registered capital and
   (b) the reserves of the company, after the distribution to shareholders is made; or
(2) the total amount of payments made to shareholders during a financial year (including return of additional payments, payments under inter-company loans, commercial arrangements, as well as any payments to shareholders on any other basis) is higher than the sum of
   (a) the amount of profit at the end of the financial year,
   (b) retained earnings from the preceding years and
   (c) the amount of reserves intended for disbursement to shareholders, minus the sum of
      (1) losses from the preceding periods and
      (2) the amount of reserves the company is obliged to maintain.

Withdrawals from the cash pool account by a parent company, and payment into 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 shareholders should ensure that the company does not become insolvent 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 abuse the company. The company is deemed to have been abused especially if the shareholder:

1. uses the company to achieve a goal which is prohibited;
2. uses or disposes of the company’s assets as if they were his/her personal assets;
3. uses the company or its assets in order to cause damage to the company’s creditors;
4. in order to reduce the company’s assets procures personal gain or gain for third parties although the person has been aware or must have been aware that the company would not be able to fulfil its obligations. In such an 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 the insolvency of 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 his duties. Thus, any intra-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, both the company’s shareholders, members of the supervisory board and/or directors may be liable to the company/ minority shareholders for damage the company suffers as a result of a breach of corporate legislation. 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 factor 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

Serbia does not have any tax provision specifically regulating cash pooling.

However, if pool members are considered related parties for corporate income tax purposes, the transfer pricing requirements should be observed. If interest rates are not in accordance with the arm’s length principle, this may result in subsequent adjustment of the pool member’s corporate income tax base.

In addition, if a company’s debt-to-equity exceeds a 4:1 ratio (10:1 for banks and financial leasing companies), interest and accompanying costs exceeding this ratio will not be deductible for corporate income tax purposes.
Slovakia

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 granting 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 considering a cash pooling arrangement:

(i) Directors’ liability

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 a 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 to its creditors if they cannot seek repayment of the debts they are owed.
Consequently, the concern of a director is that an inherent risk in cash pooling is that 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 based on a decision of a general meeting (unless the instruction of the general meeting conflicts with legal regulations). 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 a 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 sought to fulfil their duty to act in good faith.

(ii) Shareholders’ liability
The shareholders of a company are normally liable for the obligations of the company up to the unpaid value of the shareholding which they have been 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).

(iii) Unlawful profit distribution or illegal capital repayment
A Slovakian company may only transfer funds to its shareholders if it is a valid shareholder distribution, 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, 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 to be related to one other and are providing loans or deposits from their own re-sources (and not from deposits they have received from others), 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, the participants should not require a banking licence.
c) **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 any unjustified benefit for himself or a third party, he causes the insolvency of the company and thereby prevents its creditors from obtaining satisfaction of their debts.

d) **Foreign Exchange Act**
Under the Slovakian Foreign Exchange Act (measure number 264/2015 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 2m. If the cash pooling arrangement operates on a cross-border basis, the Slovak company may therefore have to make a report.

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, 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 not possible to eliminate all legal risk. 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 withdrawing 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 liquidity problems for the other participants who are relying on those returned funds. In light of this, it makes sense for the participating companies to have the 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 for the cash pooling agreement to stipulate 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 on 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, providing security and pledge provisions. If this is not possible, 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 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

1. Introduction

Cash pooling is offered only by a few banks in Slovenia. The concept of cash pooling is not regulated under Slovenian law, though there are no specific provisions prohibiting it. There is also no case law dealing with cash pooling.

However, some legal obligations apply to cross-border cash pooling in which residents are involved with non-residents. For this purpose, residents are considered to be the following:

a) corporations and other legal entities with their registered office in the Republic of Slovenia (apart from their subsidiaries abroad) involved in commercial activity;
b) subsidiaries of foreign corporations that are involved in commercial activity and are registered in the Court Register in the Republic of Slovenia;
c) private entrepreneurs who independently pursue business as an occupation with their registered office or permanent residence in the Republic of Slovenia.

Non-residents are all those not listed above.

Residents must advise the Bank of Slovenia as the supervising authority in writing about any loans received by or given to non-residents, as well as deposits with non-residents, including short-term financial obligations, which includes cash pooling, all for the purpose of macroeconomic statistics on economic relations with foreign countries. An electronic form can be found on the Bank of Slovenia website and has to be filled out and submitted online by the 20th of each month for the previous month. Once the Bank of Slovenia learns of such an activity, it sends a notice to the resident on the obligation to report.
Cash pooling may be

a) intra-company or
b) intra-group.

Furthermore, Slovenian banks offer cash pooling both in the form of the zero-balancing method and in the form of the target-balancing method. Surveys have found that Slovenian banks do not offer notional cash pooling arrangements as there is not enough interest in this.

With respect to location, Slovenian banks offer

— local and
— cross-border cash pooling.

Most of the banks offer local cash pooling based on the zero-balancing method with respect to clients’ accounts held at the same bank.

a) Intra-company cash pooling
In Slovenia, a company may open numerous regular bank accounts at the same bank, 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) Directors’ liability**

Every director of a company must act with the due diligence of a prudent businessman 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 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 can demonstrate 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, the same legal requirements as with shareholder loans may apply:

- When a member of a limited liability company (in Slovenian “družba z omejeno odgovornostjo”) provides a loan to a company in such circumstances where he should have instead (acting with due diligence) provided capital, 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 a company repaid the loan in the year prior to the commencement of bankruptcy or compulsory composition proceedings, the member must compensate the company for a sum equal to the repaid loan amount.

The above-mentioned rules similarly apply to shareholders of a joint stock company (in Slovenian “delniška družba”) who have more than a 25% 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 refund to the company all payments which they receive from the company, as dividends or assets, which 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. 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 refunding of 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 benefits from its direct subsidiary’s contribution into the cash pool. In the event of such violation of the capital maintenance rules, the amount received must be repaid by the parent company.

**d) Agreement between business enterprises**

(in Slovenian “podjetniške pogodbe”)

The Slovenian Companies Act (Zakon o gospodarskih družbah) 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 to be an undertaking contract. In such case a shareholders’ meeting should approve the agreement (as an undertaking contract) with a majority of at least three-quarters of the capital 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

According to the Slovenian Corporate Income Tax Act, in the case of loans between related parties the acknowledged interest rate should be applied for tax purposes:

— In order to determine the amount of taxable interest income, the contractual interest rate should be at least equal to the applicable acknowledged interest rate (or higher), otherwise taxable income should be adjusted.
— In order to determine the amount of deductible interest cost, the contractual interest rate should be agreed up to the level of the applicable acknowledged interest rate. If the contractual rate exceeds the acknowledged interest rate, the tax-deductible expense should be lowered accordingly.

The applicable acknowledged interest rate is determined for each individual case as a sum of:

— the published acknowledged interest rate component by the Minister of Finance;
— the mark-up for maturity of a loan; and
— the mark-up for the debtor’s credit rating based on Standard & Poor’s ranking or that of another similar credit rating agency.

Since 2008, the legislation has enabled taxpayers to prove that their contractual inter-company interest rate, which is not in line with the applicable acknowledged interest rate, is at arm’s length. Consequently, the contractual interest rate agreed between affiliated persons can be used for tax purposes only if its arm’s length nature can be proved.

The parties involved can prove the arm’s length nature of their contractual interest rates by conducting a transfer pricing study. Furthermore, the tax authorities have issued written clarification that taxpayers can also use comparable interest rate quotes received from third parties or commercial banks. The acceptability of such quotes will, however, be considered by the tax authorities on a case-by-case basis.

In practice, this means that should the party to the cash pooling agreement, a tax resident of Slovenia, not be able to prove the arm’s length nature of the contractual interest rate, which would also not be in line with the acknowledged interest rate, it should make the necessary adjustments to the level of taxable/deductible interest through its annual corporate tax returns.

Additionally, note that any non-arm’s length interest paid by a Slovenian tax resident to an entity which directly or indirectly holds at least 25% of its shares or voting rights may be regarded as a hidden profit distribution and subject to withholding tax as a deemed dividend.


b) Thin capitalisation
Thin capitalisation rules may apply to interest paid in respect of the cash pooling agreement. Except in the case of loan recipients which 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 corporate income tax (at the rate of 19%) on such interest, unless the company provides evidence that it could have received the surplus from a lender who 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.

c) Withholding tax
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, where the interest recipient is a Slovene resident and has notified the payer of his Slovene tax number;
— on loans, where the interest is paid to the Republic of Slovenia, local authorities in Slovenia or the Bank of Slovenia;
— on loans raised by and securities issued by the Republic of Slovenia;
— on loans raised and issued by an authorised institution, in accordance with the law regulating insurance and financing of international business transactions, for which guarantees are issued by Slovenia;
— paid by banks – other than interest paid to companies which 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 on a list published by the minister responsible for finance.
— on loans paid by Slovenia to a borrower of state debt securities on assets in line with Article 83 of the Public Finance Act.
Furthermore, in line with the implemented Interest & Royalties Directive, 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:

(i) 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

(ii) the payer and the beneficial owner are related, so that
  - the payer of the tax directly participates in at least 25% of the beneficial owner’s share capital or
  - the beneficial owner directly participates in at least 25% of the share capital of the payer or
  - where participation between companies of the EU is concerned, a parent company directly participates in at least 25% of the capital of both the beneficial owner and the payer;
  - and, in each instance, the minimum 25% participation lasts at least 24 months; and

(iii) 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 finance minister;
  - in accordance with the tax laws of an EU member state considered to be a resident of that state for tax purposes and, under the terms of a double taxation agreement concluded with a third state, is not considered to be resident 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 finance minister, where a company exempt from tax is not deemed to be 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 in a country with which Slovenia has concluded a double taxation treaty providing for withholding-tax relief/exemption.
Spain

There are no specific laws governing cash pooling activities in Spain. Nor have any judicial decisions been made on cash pooling to date (although decisions made in the context of insolvency proceedings may be applicable by analogy – see below). Instead, one must look to other areas of Spanish law (in particular, banking, corporate and insolvency law) in order to establish the parameters within which cash pooling may operate.

1. Banking law

Cash pooling in Spain is not one of the activities reserved exclusively for financial institutions. In general, the only activity reserved for financial institutions in Spain is the receipt of refundable funds from the public in the form of deposits, loans, temporary transfers of financial assets or similar, for whatever purpose.

In general, therefore, no special authorisation needs to be obtained by any of the entities participating in the cash pooling arrangement (other than the bank). This is true even of a treasury company, whose activities may be considered similar in some respects to those of a financial institution.

Spanish residents are obliged to notify the Bank of Spain about transactions entered into with non-Spanish resident counterparties that are satisfied by means of bank transfers, credit or debit in bank accounts or intragroup accounts, setting-off or cash delivering, and about creditor balances and variation in assets and liabilities held vis-à-vis non-Spanish resident counter-parties. The periodicity of the notifications to the Bank of Spain varies depending on the aggregate amount of the transactions carried out the previous year.
2. Corporate issues

There are few corporate law limitations on cash pooling arrangements:

Cash pooling activities need not be listed as a specific corporate object in the articles of association of the company in order for the company to lawfully engage in such activities. Instead, cash pooling is treated as an ancillary activity, undertaken in order to further the main objects of the company (in the same way as lending money, granting security and giving guarantees).

Nor does Spanish law generally limit the amount of debt which a company can assume (save insofar as certain thin capitalisation rules may apply – see below). Furthermore, whilst a company may be subject to compulsory liquidation if its net assets fall to a level below half its share capital, this is unlikely to occur as a direct consequence of a cash pooling arrangement.

However, it should be borne in mind that a cash pooling arrangement could potentially adversely affect the liquidity of a participating company to such an extent that such company is unable to pay its debts as they fall due and therefore faces insolvency.

In general, directors of a Spanish company are required to perform their duties with the diligence of a reasonably prudent businessman acting in the best interests of the company. A breach of such duty by a director will result in him being liable to the company’s shareholders and the creditors for any losses they suffer as a result. The directors will be in breach of their duty if, for example, they enter into a cash pooling agreement on terms which may adversely affect the company or if they fail to withdraw from the cash pooling arrangement when the financial viability of the rest of the group deteriorates to such an extent that the company may not be able to recover sums it has contributed.

The business judgment rule applies, so in order to protect the directors of the Spanish participant from incurring personal liability, the directors of each individual pool participant must have access to information which allows them to form an opinion on the financial situation of the pool leader and the group as a whole.

---

3 The amount a Spanish company may borrow by way of a bonds issue is limited to the amount of the company’s paid-up share capital, but this restriction does not apply to borrowings of any other nature.
If the cash pooling transactions represent an amount equal to or higher than 25% of the assets of the company, it is necessary to obtain a general shareholders meeting resolution approving the execution of the cash pooling agreements and related documents by the directors. However, it is advisable to obtain such a resolution in any case, so that it is evidenced that the shareholders back the decision of the directors. Please note that as a consequence of recent reforms to the Spanish Companies Act, the resolution of the shareholders does not waive the directors’ liability.

In addition, criminal liability of the directors (and de facto directors) may arise, mainly when they act in the performance of their duties in a disloyal or fraudulent manner (seeking their own benefit or that of a third party and thereby directly causing economic harm to the shareholders), when they cause the company to enter into extortionate agreements in order to cause injury to the shareholders, or in the event of falsifying financial or corporate information.

The question of whether a director has performed his duties with the requisite level of diligence must be evaluated solely with regard to the company itself and not the group as a whole. Therefore, even where a company’s participation in a cash pooling arrangement benefits the group as a whole, the company’s directors will incur liability (civil and in some aforementioned circumstances even criminal) if the directors have not fulfilled their duty with regard solely to the company itself.

The directors may also incur liability if they fail to instigate winding-up proceedings in circumstances where the net assets of the company fall to a level below half its share capital or if they fail to apply for a declaration of insolvency when it becomes legally obligatory to do so. In such circumstances, they may become jointly and severally liable for any debts of the company which subsequently arise. This is in addition to any liability the directors may face on other grounds connected with the company’s insolvency.
In general, the insolvency of a Spanish company involved in a cash pooling arrangement will not automatically result in early termination of the cash pooling agreements. Given the nature of cash pooling agreements, however, the insolvency trustees will usually ask the court for their termination, at least between the company and the other participating companies, in accordance with Article 61.2 of the Spanish Insolvency Act, provided such termination benefits the procedure and the insolvent company.

It is important that the cash pooling arrangement be clearly structured and properly managed so as to ensure that the rights and liabilities of each participating company in respect of sums transferred to and from the cash pool are transparent at all times. An insolvency procedure relating to one participating company could have adverse effects on other participants if the financial relationships between the participants cannot be easily determined.

In some insolvency procedures in Spain, inadequate management of inter-company loans or other similar intra-group legal relationships have resulted in serious difficulties in determining the amounts owed, and the exacerbation of the situation which this causes can even result in the insolvency qualifying as having been negligently caused. It could even result in liabilities of the persons involved who were aware of the situation (directors, auditors, etc.). In such circumstances, they may become liable for the debts of the company.
Where the centralising entity is a Spanish resident, the precise role that it plays may be essential for determining whether any remuneration it receives from participating companies constitutes interest or management fees. Where the centralising entity essentially performs the role of a bank (i.e. receiving physical deposits from the participating companies), such payments will typically be regarded as interest. Where the centralising entity acts as an intermediary between the group and the bank, such payments will usually be classified as management fees.

If one or more of the participants of the cash pooling arrangement is a Spanish resident(s), there are a number of aspects of Spanish tax law which should be considered. Relationships of the participants and any remuneration they pay/receive in the form of interest/management fees (see above) should be governed by arm’s length terms.

In addition, limitation on interest deductibility for tax purposes shall be considered. Generally, net financial expenses (financial expenses less financial income) exceeding 30% of the operating profits of a company, as defined by the Spanish tax legislation, are not tax deductible. In any case, a minimum net financial expense amount (floor) of EUR 1m is deductible in the tax period. More specifically, interest expenses incurred during the tax period derived from debt to group entities for the acquisition, from other group entities, of shares in the capital or equity of any type of entities, are not deductible.

Furthermore, stricter transfer pricing rules are applicable in Spain, so care must be taken as regards the level of remuneration the parties pay and receive in the form of interest payments and management fees and the intra-group cash transfers must be documented carefully. If arm’s length rules are not complied with, the Spanish Tax Administration is entitled to make the corresponding adjustments, so that deductible expenditure or taxable income is reported on an arm’s length basis and the Spanish resident entity is taxed accordingly. Penalties can be imposed if pricing and documentation regulations are not complied with.

Finally, it should be borne in mind that interest payments made by a Spanish resident will not be subject to withholding tax as long as the recipient of the interest is an EU tax resident. Otherwise a 19% withholding tax would apply, with the possible benefit of reduced rates under the provisions of an applicable double taxation treaty. Tax form filing obligations also apply to the paying Spanish resident.
Legal framework for cash pooling

There is no specific statutory framework dealing with cash pooling in Switzerland. However, until 2014, it was generally agreed in the literature on the subject that the rules and limitations contained in the statutory provisions and related case law on capital maintenance and profit distribution will apply in certain circumstances to the contribution of funds to a cash pool. In a landmark decision rendered in 2014, the Swiss Federal Court provided very severe guidelines that should be considered by companies participating in a physical cash pool. In its judgement that provoked many, mostly critical, responses from commentators, the Swiss Federal Court confirmed that the provisions on capital maintenance (prohibition to return paid-in capital and statutory reserves) and on dividend distribution set limits to the granting of upstream or cross-stream loans. In particular, these loans must not constitute a distribution of protected equity towards the shareholder under the guise of a loan.

Theoretically, there are no restrictions on the granting of loans by Swiss companies to their affiliates, and such intra-group loans are not subject to the limitations contained in the statutory provisions on capital maintenance and profit distribution mentioned above – provided, however, that such intra-group loans are granted on terms and conditions which are arm’s length in all respects. This requires not only that interest be paid at the market rate, but also that the protections that a commercial lender would usually require apply (in particular, assessment of the solvency and creditworthiness of the borrower and the right of the lender to prematurely terminate the loan if the financial situation of the borrower deteriorates, and appropriate risk diversification (i.e. no bulk risks)).

In its 2014 landmark decision, the Swiss Federal Court set very severe guidelines regarding the arm’s length test. In the specific matter, however without checking the above criteria in a detailed manner, it laid a special focus on the (non-) provision of collateral and the (non-)assessment of the solvency of the debtor. The fact that the loans were not secured and the lender did not consider the solvency of the borrowers (despite indications on financial distress appearing on the horizon) led the court to conclude that the transactions were not at arm’s length.
If an intra-group loan (other than a mere downstream loan) is found not to be at arm’s length, any sums transferred to the borrower under the loan will be treated as a profit distribution or – if such payment exceeds the amount of the freely distributable reserves of the lender – as a capital repayment. Both of these situations are subject to balance sheet limitations and strict formal requirements. The decision of the Swiss Federal Court mentioned above also introduced a novel concept whereby upstream or cross-stream loans lead to a blocking of free equity in the amount of the loan granted, i.e. the dividend distribution capacity of a Swiss legal entity is decreased by the amount of the upstream and/or cross-stream loans granted (assuming that the severe arm’s length test criteria are not satisfied). As a consequence, it may be advisable to also formally recognise this new type of reserve in the balance sheet.

Auditors now generally require that the board of directors provide evidence that an arm’s length analysis has been performed and that it came to a final conclusion. If no documentation is available on such analysis or if the board of directors or experts engaged express doubt as to the satisfaction of the arm’s length test, the intragroup loan would not be considered at arm’s length and the auditors would make a respective note in their report. According to the 2014 landmark decision of the Swiss Federal Court, the balance sheet date is decisive for the determination of the relevant balance sheet values, in particular the freely distributable reserves and with respect to the question whether enough distributable funds are available. From the court’s decision, it can be deduced that even a subsequent (full) reimbursement of the loan does not liberate blocked reserves. Such reserves may only be distributed if a subsequent audit confirms that they are freely distributable.

The above applies equally to intra-group guarantees which are granted in connection with a notional cash pooling arrangement and to the actual fund outflows in case a guarantee is called upon.

In addition, the directors and managing officers of the company are responsible for ensuring that the company has sufficient liquidity at all times to pay its debts as they fall due. There is a risk that sufficient liquidity will not be available if funds paid into a cash pool are suddenly no longer recoverable or an intra-group guarantee given by the company is called upon.
2. Liability risks

Deviations from market conditions may provide for a heightened duty of care in the monitoring of the loan. If the transfer of sums to a physical cash pool or the grant of, or payment under, an intra-group guarantee is made in contravention of the capital maintenance and profit distribution provisions, or as a result of these actions the company becomes insolvent due to a lack of liquidity, the members of the board of directors and the management of the company may become personally liable for the shortfall. In certain circumstances, the immediate parent company and the ultimate group parent company may also become liable. Furthermore, the auditors may also face liability if the above rules are violated.

3. Legal structure to reduce liability risks

In practice, it is usually impossible to comply with the arm’s length requirement referred to above in all respects. This is particularly so in the case of a cash pool where the intra-group loan relationships are not established directly by the individual group companies but rather through the cash pool bank as an intermediary. Furthermore, the question whether an intra-group agreement complies with market standards is almost invariably open to argument and it is therefore difficult to predict whether a judge will ex post confirm that a particular intra-group agreement is arm’s length in nature.

It is therefore highly advisable to take the appropriate measures to ensure that the aggregate potential loss that a Swiss company could suffer in relation to a cash pooling arrangement is limited at all times to the amount of the freely distributable reserves. When calculating the freely distributable reserves, the mandatory allocation to the legal reserve and possible withholding tax due on distributions must be taken into account. Also, dividend distributions should be made in excess of the (de facto) blocked amount only.

In the case of intra-group guarantees (e.g. in the event of a notional cash pool), the risks can be limited by agreeing with the bank that the exposure under the guarantee shall be limited to the amount of the freely distributable reserves as shown in an audited interim balance sheet as at the date the respective guarantee is called upon. This is nowadays considered established market practice in Switzerland and is therefore usually accepted by the bank.

In a physical cash pool, however, the only way in which such limitations can be maintained is by the rather cumbersome manual control of the flow of funds in order to make sure that assets exceeding the freely distributable reserves are at no time blocked in the cash pool.

In addition, as discussed above, it must also be ensured that even if all funds contributed to the cash pool or paid under an intra-group guarantee are lost, the company still has sufficient liquidity to pay its debts as they fall due.
Furthermore, the articles of association of the concerned companies should explicitly include in the purpose clause the granting of financing to other group companies, including through upstream and cross-stream loans and securities as well as participation in cash pools. Moreover, the purpose clause should explicitly state that the concerned companies may promote the interests of other group companies, even without receiving adequate consideration (i.e. consideration that is not at arm’s length).

Finally, it should be noted that both participation in a physical cash pool and the granting of intra-group guarantees in connection with a notional cash pool require approval by unanimous resolution at a meeting of shareholders.

4. Tax aspects

In principle, any payments to or – in the case of an intra-group guarantee – for the benefit of affiliates (except for pure downstream payments) made under obligations which are not at arm’s length constitute profit distributions for tax purposes, with the result that, firstly, the respective payments cannot be set off as business expenses against taxable profits and, secondly, Swiss withholding tax of 35% becomes due on such payments (to be grossed up to 53.8% if the burden of the withholding tax is not passed on to the recipient of the payment). Depending on the domicile of the beneficiary and the applicable double taxation treaty, the Swiss withholding tax may be partly or fully refundable. This applies regardless of whether the respective payment is made only out of the freely distributable reserves of the company or not.

In practice, it may be possible to reach a binding agreement with the Swiss tax authorities (in a so-called “ruling”) that payments of a Swiss company under a physical cash pool or an intra-group guarantee system do not qualify as profit distributions, based on the argument that the cash pool system is sufficiently beneficial for the Swiss company (both directly and indirectly through the advantages to the group as a whole) to justify the related payments and solvency risks. However, the tax administration will carefully review the interest rates in order to determine their arm’s length quality, in particular if the agreed interest rates deviate from the safe-haven interest rates for intra-group lendings as annually published by the federal tax administration.

Moreover, if the pool leader is resident in Switzerland, particular attention must be paid to the Swiss tax definition of client deposits, since withholding tax may be triggered on the interest payments of the pool leader if its number of creditors exceeds certain thresholds. In this respect, certain changes to the Federal Ordinance on Withholding Tax will come into effect on 1 April 2017 which should facilitate setting up a cash pool in Switzerland.
Turkey

1. Legal Framework for Cash Pooling

Cash pooling mechanisms (zero balancing agreement or notional cash pooling) are not specifically regulated under Turkish law. Therefore, the general principles of Turkish law shall apply regarding the liability issues that may arise in connection with setting up and operating a cash pool and any restrictions that may be applicable for the same.

Furthermore, it should be noted that Turkey enacted a new commercial code (“TCC”) in 2012 and therefore precedents on various principles regulated under the TCC are yet to be established. Additionally, as cash pooling mechanisms are relatively unorthodox under Turkish legal practice and are not specifically regulated under any specific piece of Turkish legislation, it is unclear to what extent certain principles outlined under the TCC and other pieces of Turkish legislation would become applicable vis-à-vis a cash pooling mechanism.

On the other hand, from a general perspective, monies transferred as part of a cash pooling mechanism shall be considered as loans granted by the disbursing company to the borrower company that owns the cash pool account. In this regard, various legal and tax related implications would arise in connection with the establishment of such a cash pool mechanism, as further outlined herein below.

2. Liability Risk

There are two commonly used types of legal entities under Turkish legal practice, namely joint stock companies (anonim şirket) (“JSC(s)”) and limited liability companies (limited şirket) (“LLC(s)”). In this regard, the explanations regarding the risks of implementing a cash pooling mechanism have been outlined below separately for JSCs and LLCs.

a) General Liability of Directors/Managers under Turkish Law

JSCs are, in principle, managed and bound by their Board of Directors (“BoDs”). The members of the BoD (“Director” or “Director(s)”) are required to act prudently (also referred to as the “business judgement rule”) in their duties undertaken for the relevant JSC. Furthermore, the Directors are under a liability based on negligence towards the JSC, the shareholders and the creditors of the JSC. This means that, where the JSC, its shareholders or its creditors suffer damage due to the negligent actions of a Director or Directors, such Director or Directors shall be required to compensate the relevant party for such damage.
In this regard, if the cash pooling arrangement results in any losses for the JSC, Director(s) who have authorised and signed off on that arrangement shall be liable for the compensation of such loss, to the extent that such Director or Directors have acted with negligence in that respect. On the other hand, Directors who oppose the implementation of such cash pooling system may be exempt from liability by virtue of the differentiated liability principle (farklılaştırılmış teselsül) introduced under the TCC, whereby directors shall only liable for the losses incurred due to their negligent actions, as compared to any general liability attributable solely to a director status.

For LLCs, the management and representation duties are undertaken by manager(s) ("Manager(s)") (at least one of whom must be a shareholder). The principles of liability of the Managers towards the LLC, arising from the management duty of such LLC, are in principle the same as those of the Directors of a JSC. Thus, where the LLC, its shareholders or its creditors suffer damage due to the implementation of a cash pooling mechanism (and the Managers in question have acted with negligence in relation thereto), such Manager or Managers shall be required to compensate for the damage. The differentiated liability principle explained above shall also apply in the case of LLCs and therefore Manager(s) who oppose the implementation of a cash pooling system should be exempt from any liability arising due to any losses incurred in relation to such mechanism.

b) Liability Arising from Group Company Principles

Turkish law foresees a set of restrictions for JSCs where parent companies and their affiliated companies are restricted from entering into certain transactions. These differ, based, in principle, on whether the parent company wholly owns the affiliated company or only partially owns it.

Accordingly, where an affiliated company is not a wholly owned affiliate of a parent company, the parent company will not exercise control over the affiliate in a way that would lead such affiliate to incur any losses, unless:

(i) Any loss arising due to such transactions is remedied within that financial year; or
(ii) A right of claim equivalent to the value of the loss incurred by the affiliate due to the transactions above is granted to the affiliate no later than by the end of the respective financial year, with a specific explanation of how and when this loss will be recovered.

Where an affiliate is a wholly owned affiliate of the parent company (whether directly or indirectly), the Directors of the parent company may give instructions and management orders to the affiliated company which could cause loss for the affiliated company only if such instructions and orders are within the pre-determined substantial policies of the group companies.
However, even when the parent company is the 100% owner of the affiliated company (directly or indirectly), the parent company must not give directions and orders, at any rate, to the affiliated company which clearly:

(i) Exceed the financial means of the affiliate; or
(ii) Which will cause the affiliated company to lose significant assets belonging to such company.

Due to the fact that cash pooling arrangements are relatively rare in Turkey and the restrictions outlined above have been enacted rather recently, it is currently unclear in Turkish legal practice as to whether the above restrictions would also apply to a cash pooling arrangement. However, due to the lack of clarity regarding this matter, it would be prudent to take into consideration the above restrictions while setting up a cash pool mechanism.

Failure to comply with the restrictions above would have the following consequences:

(1) Where the Affiliated Company is not Wholly Owned by the Parent Company:
   (a) The shareholders of the affiliated company may be entitled to ask for compensation of the losses from the parent company and the relevant Director(s) of the parent company;
   (b) The lenders of the affiliated company may be entitled to request that the losses suffered by the affiliated company be compensated;
   (c) The shareholders of the affiliated company may request that the parent company purchase the shares held by the said shareholders in the affiliated company; and
   (d) The Directors (or other managers) of the affiliated company may request that the parent company assume all liabilities that may arise in detriment of the shareholders of the affiliated company to be assumed by the parent company under a contractual arrangement.

(2) Where the Affiliated Company is Wholly Owned by the Parent Company:
   (a) The creditors of the affiliated company may be entitled to ask for compensation of the losses suffered by the affiliate from the parent company and the relevant Directors of the parent company.

The restrictions explained above should only be applicable to JSCs under Turkish law (and not other forms of companies such as LLCs). However, since this is a recently introduced restriction, there is no market practice or jurisprudence as to how this would apply.
c) Liability Arising from Loans Granted to Shareholders

As the parties (JSCs and LLCs) to a cash pooling mechanism shall generally be considered as granting loans to each other, Turkish legislation regarding loans granted to shareholders should also be taken into consideration in setting up a cash pooling mechanism.

Pursuant to Turkish law, a shareholder (i.e. parent company) must not take out a loan from an affiliated company unless that shareholder has

(i) Already paid its due share capital; and
(ii) The profit of the affiliated company along with its freely usable capital reserves are sufficient to cover any losses incurred by the said company over the previous years.

In this regard, an affiliated company could face monetary fines if it sends monies to the cash pool accounts of its parent company where

(i) The direct shareholder of such affiliate has not yet deposited the respective share capital into the accounts of the affiliate; or
(ii) The capital reserves of the affiliated company are not sufficient to cover losses (if any) incurred in previous years.

In this regard, where a Turkish entity is party to a cash pooling system, such entity should observe the principles above.

d) Liability Arising from Capital Adequacy Principles

Pursuant to Turkish law, as part of the “protection of the share capital principle”, shareholders, in principle, cannot ask for a refund of the share capital they have deposited in a JSC or an LLC. In this regard, any resolution or transaction according to which such share capital is repaid to the shareholders (in an explicit or disguised manner) may be considered void or be challenged by, among others, the affiliated company, the creditors or the shareholders of the affiliated company.

Furthermore, the share capital of JSCs and LLCs must be maintained at all times. The loss of the share capital would require, among others, the general assembly of shareholders of the relevant company to convene and decide on the relevant remedies for such loss.

In this regard, a cash pooling mechanism effected by and between the affiliated companies and parent companies should not result in the repayment of the share capital deposited by the parent company or in the loss of the share capital of the affiliated company.
3. Restrictions Regarding the Implementation of a Cash Pooling Mechanism

a) Corporate restrictions
A cash pooling arrangement may be prohibited (directly or indirectly) under the articles of association (“AoA”) of the relevant company (a JSC or an LLC) (the “Company”). Similarly, entering into such arrangement may be subject to certain corporate approvals of the Company’s statutory bodies (i.e. the BoD resolutions or general assembly of shareholders resolutions) according to the AoA or other contractual arrangements such as shareholders agreements (“SHA”) which may be binding on the Company and its shareholders. Furthermore, under Turkish law, the AoAs mandatorily regulate the distribution of profit, setting aside of legal reserves and the disposal of any other income derived by the companies in question. These issues are customarily regulated under other contractual arrangements as well (e.g. SHAs). In this regard, the Company could duly enter into a cash pooling arrangement only if such arrangement is not restricted under the statutory documents of, or other arrangements binding on, the Company.

b) Regulatory restrictions
In Turkish legal practice, only banks and certain financial institutions are allowed to lend money to third parties as part of their customary commercial activity. Thus, if entities party to a cash pooling arrangement are exclusively engaged in a lending activity and derive income (i.e. interest) solely from such activity, this may be considered a breach of the Turkish Banking Law (under which banks and certain financial institutions are granted exclusive rights to be engaged in lending activity).

It should be noted that, as cash pooling mechanisms are not common practice in Turkey, it is not possible to determine whether a cash pooling arrangement qualifies as such extensive lending activity and constitutes a breach of the said law.

4. Tax Matters

As discussed above, Turkish tax legislation, in principle, also views cash pooling arrangements as a loan granting mechanism. Thus, the tax law implications of a cash pooling mechanism arise from such assumption and differ on the basis of the residency of the entities (the “Lender” and the “Borrower”) party to that cash pool. Accordingly, further information regarding cash pooling mechanisms is provided below based on this distinction:

a) The Lender and the Borrower are both Turkish Companies
Where both the Lender and the Borrower are Turkish companies, the Lender must accrue interest at arm’s length on the amounts sent to the cash pool owned by the Borrower. The interest will be subject to value added tax (“VAT”) at the rate of 18%. The interest received will be considered as income for the Lender and be subject to corporate income tax. Further, if the borrowed amount exceeds three times the shareholders’ equity of the Borrower, the interest accrued on the excessive amount will be considered as thin capital and constitute a non-deductible expense for the Borrower.
b) The Lender is a Turkish Company and the Borrower is a Foreign Company

In this case, the Lender must accrue interest on the loan granted to the Borrower in line with the arm’s length principle. If the loan granted to the Borrower will be used in a foreign jurisdiction, the interest on the loan will not be subject to Turkish VAT, but will be considered as income for the Lender and accordingly be subject to corporate income tax.

c) The Lender is a Foreign Company and the Borrower is a Turkish Company

In this case, the interest paid to the Lender on the loan must comply with the arm’s length principle and will be subject to withholding tax at the rate of 10% as well as VAT at the rate of 18%. The VAT paid on the interest amount may be deducted from the entire VAT payable by the Borrower.

Any interest payment in excess of the arm’s length principle will constitute a non-deductible expense for the Borrower and be considered a dividend payment to the Lender. In that case, such excessive interest will be subject to Turkish withholding tax at the rate of 15%; however, a lower percentage may be applicable under the relevant double taxation treaty.

A written loan agreement (or other arrangement on the basis of which the amounts in question are transferred from the Lender to the Borrower) will be subject to stamp tax at the rate of 0.948% based on the highest monetary amount indicated under such agreement.

If the amount sent to the cash pool of the Borrower is in a foreign currency and the maturity of the loan is shorter than three years, a further deduction, namely, the Resource Utilisation Support Fund (more commonly referred to as the “RUSF”) will be applicable to such loan at a rate between 0.5% to 3% (depending on the actual term of maturity). The RUSF is not applicable (i.e. is reduced to 0%) to foreign currency loans with a term of maturity equal to or longer than three years.

If the amount sent to the cash pool of the Borrower is in Turkish lira and the maturity of the loan is shorter than one year, the RUSF will be applicable to Turkish lira loans with a term of maturity equal to or longer than one year.

Lastly, if the borrowed amount exceeds three times the shareholders equity of the Borrower, the interest accrued on that excessive amount will be considered as thin capital and will constitute a non-deductible expense for the Borrower. In that case, the excessive interest will be considered a dividend payment and be subject to Turkish withholding tax at the rate of 15%; however, a lower percentage may be applicable under the relevant double taxation treaty.
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 commercial effects that are similar to the standard cash pooling concept.

1. Types of arrangements in Ukraine

   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:

   (i) 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.

   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.

   It is important to note that if one of the contributing participants is a non-resident, the RFA agreement must be registered with the National Bank of Ukraine.

   (ii) 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 must be registered 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.

It should be noted that early repayment of a cross-border loan is currently prohibited.

(iii) 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.

The following risk avoidance measures should be borne in mind when carrying out a cash pooling transaction:

— To reduce risks, all necessary corporate approvals (required pursuant to a company’s charter) 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 that threaten to swallow the pooled cash.
For a notional cash pooling arrangement to work, the bank needs to have a legal right of set-off against a company’s credit balances to clear the debit position of the other companies in the pool. Essentially, this means that each company in the pool must agree to guarantee the liabilities of the other companies to the bank (cross-guarantees). Although a cross-guarantee structure is not normally essential in the case of physical cash pooling, in practice cross-guarantees are often taken.

Under a physical cash pooling arrangement, every time its account is swept, each company in the pool effectively swaps cash for a debt owed to it by the pool leader/treasury company.

The directors of each company that proposes to enter into a cash pooling arrangement will need to satisfy themselves that, on balance, the actual or potential detriment to the company of the pooling arrangement is outweighed by its actual or potential benefit.

In the case of physical cash pooling:

— the main risks are likely to be the pool leader not repaying each debt to the company in full, either because of its own cash shortages or those of other pool members, and the weak cash position of the pool leader or other pool members reducing the ability of the company to draw on the master account; and

— the main benefits are likely to be that the company may be able to obtain a higher rate of interest on the pooled cash than it could obtain if the cash were held in its own separate account.

It may also be possible to identify savings related to the centralisation of cash management – e.g. lower treasury and back-office costs, lower overdraft fees or lower interest charges on debit balances.

Finally, where a benefit to the group as whole, or to a key member of the group, may indirectly benefit the company, this can be taken into consideration. For example, the company may benefit where entry into a transaction is necessary to ensure continued funding for the group and the group’s activities are so closely interconnected that the failure of one group entity would adversely affect all the others. However, it is not sufficient that the arrangement only benefits the group as a whole.
2. Corporate capacity

An English company can enter into a cash pooling arrangement provided that the transactions involved (e.g. lending to other group companies or the granting of cross guarantees) are permitted by the company’s constitution. If there is any doubt about whether the transactions are permitted, the company should first obtain a shareholder resolution to amend the constitution. If, for some reason, a company enters into a cash pooling arrangement that is not permitted by its constitution, in most circumstances the bank and other group companies should nevertheless be able to enforce the arrangement against the company, but the directors will be liable to the company for exceeding their authority.

In addition to constitutional matters, the company would need, of course, to comply with its existing contractual obligations (e.g. in financing agreements), which may restrict the making of loans, the granting of guarantees or the incurring of financial indebtedness. Where restrictions apply, the company will need to obtain waivers or consents in order to enter into the pooling arrangements.

3. Formalities

As a practical measure to give assurance that, overall, the arrangement benefits the company, the company’s board of directors should pass a resolution confirming that it has considered the matter and concluded that the arrangement and related transactions should be approved. It may be helpful to identify in the board minutes the benefits expected (whether tangible or intangible) and to include the board’s assessment of the solvency of the company and other pool members.

One or more directors should be tasked with monitoring the risks and benefits of the arrangement, and reporting back to the board, on a regular basis. This will entail monitoring the financial position of the other pool members. The pooling arrangement should be terminated if and when the board concludes that the level of risk to the company outweighs the benefit – e.g. because a serious deterioration in the financial position of another pool member makes it likely that the bank will call on the cross-guarantee or that a loan will not be repaid.

In addition, where a company is proposing to guarantee the liabilities of its parent or sister companies, it is usual practice to obtain a shareholder resolution approving the guarantee. This can reduce or eliminate the risk of the company subsequently (perhaps at a time when it is under the control of a new owner) challenging the validity of the arrangement on the basis that it was not in the best interests of the company. However, such a resolution will not be effective if the company is insolvent, or threatened by insolvency, at the time of the resolution. Nor will it prevent the guarantee being challenged as a transaction at an undervalue or a preference under insolvency legislation (see paragraph 4 below).
For any notional cash pooling arrangement operating in England, certain requirements must be satisfied to enable the bank to report net exposure to the Prudential Regulatory Authority. These requirements include that:

— the “on-balance sheet netting arrangements” must be legally effective and enforceable in all relevant jurisdictions, including in the event of insolvency or bankruptcy of a counterparty;
— the bank must be able to determine at any time those assets and liabilities that are subject to that arrangement;
— the bank must monitor and control the risks associated with the termination of the credit protection on an ongoing basis; and
— the bank must monitor and control the relevant exposures on a net basis and do so on an ongoing basis.

4. Insolvency issues

If an English company which gives a cross-guarantee for the purposes of a notional cash pooling is subsequently found to have been insolvent at that time or becomes insolvent as a result, the cross-guarantee may be challenged as a “transaction at an undervalue” or a “preference”. Under section 238 of the Insolvency Act 1986 (the “Insolvency Act”), the guarantee could be at risk as a “transaction at an undervalue” if it is given within two years of the commencement of insolvency proceedings in respect of the company. Under section 239 of the Insolvency Act, the guarantee could be at risk as a “preference” if it is given within either two years or six months of the commencement of those proceedings (depending on whether it is given to a person connected to the company).

Similar considerations apply to a physical cash pooling arrangement but, in practice, inter-company payments made as part of that arrangement are unlikely to be attacked as a “transaction at an undervalue”, because:

— the “value” in this context would be expected to consist of the loan that would arise by virtue of each relevant cash transfer; and
— the company transferring cash is likely (because of its persistent credit balances) to be in a relatively strong, rather than weak, financial position and accordingly the danger of it being insolvent at the time of the payment should be remote.

Any inter-company payments made under pooling arrangements may not be made following the commencement of a winding-up procedure. Accordingly, if a winding-up resolution is passed by the company or a winding-up petition is presented to the court, the pooling arrangements could only be relied on in relation to inter-company payments made prior to such time or in relation to debts incurred in favour of the bank prior to that time.

Any netting which had actually been completed by the time the winding-up commenced (such completion being evidenced by the substitution of one debt owed by one entity for several debts owed by and to several entities) would survive.
5. Other issues

Unless the pooling arrangements somehow constitute financial assistance in connection with the acquisition of the shares of an English company (e.g. where the company is required by the buyer’s lending bank to enter into a cash pooling arrangement that will reduce the buyer’s liability to that bank) or involve an unlawful return of capital (see below) or misconduct on the part of the directors, there should be no corporate, civil or criminal liability issues for the English company or its directors or managers.

An arrangement that involves a transfer of assets (e.g. a loan), or the assumption of a liability (e.g. a guarantee), that in either case is for the benefit of one or more shareholders, may amount to an unlawful reduction of capital if, as a result of the arrangement, there would be a reduction in the net assets recorded in the company’s books and that reduction exceeds the amount of the distributable reserves of the company. An arrangement that constitutes an unlawful return of capital will be void and recipients may be liable to account to the company for assets received.

To reduce the risk of a cash pooling arrangement being challenged on this basis, it will be helpful, where relevant, for board minutes to demonstrate that the directors have considered whether the arrangement will lead to a reduction in net assets and, if so, the amount of profits available for distribution. This will involve an assessment of the likelihood of any loan not being re-paid or any guarantee being called and, under some accounting standards, the market value of a loan made or a guarantee given. If, on normal accounting principles, the loan or guarantee does not require an immediate accounting loss to be recognised, there will be no unlawful return of capital.

If a director acts in breach of any fiduciary duty to the company in entering into the pooling arrangement, he will be liable to indemnify the company for any loss it suffers as a result, and to account to the company for any profit he makes.

In particular, where a director of one group company (company A) is also a director of another company within the pool (company B), he may, in approving the pooling arrangement, be in a position where his duties to company B conflict with his duties to company A – particularly if one of the companies stands to bene-fit from the arrangement to a much greater extent than the other. In such circumstances, unless the constitution of each company permits the director to take part in the approval process despite the conflict, best practice is for the director to step out of the discussions on both boards. Where this is not practicable, the prudent course is to obtain a shareholder resolution to authorise the director to participate despite his position of conflict.

Ultimately, if the cash pooling arrangement is for the commercial benefit of the company and the shareholders have approved it, there should be no liability for the directors.
6. Tax issues

a) Interest deductibility

Interest on loans is deductible if the loan is a “loan relationship” (i.e. a money debt). The interest will be deductible in accordance with relevant accounting treatment. Any loan relationship entered into for unallowable purposes (which includes tax avoidance) will not be deductible.

There is a further limit on deductibility where interest is paid to a connected party and:

— the full amount of the interest is not assessable on the lender under the loan relationship legislation (i.e. where the lender is outside the charge to corporation tax); and
— the interest is not paid within 12 months of the end of the accounting period in which it was accrued.

Tax relief in respect of interest payments is also denied (under section 443 of the Corporation Tax Act 2009 (“CTA”)) when a scheme has been made and the sole or main benefit that might be expected to accrue was the obtaining of a reduction in tax liability by means of the relief. However, relief is rarely denied on these grounds.

Payments of interest may be re-characterised as a dividend in the following circumstances:

— to the extent that any interest that exceeds a commercial rate of return under section 209(d) of the Income and Corporation Taxes Act 1988 (“ICTA”);
— where the interest is payable on a debt which is more like a share than a debt (by virtue of section 209(e) ICTA); and
— where the interest is payable on securities which are convertible, directly or indirectly, into shares of the company, unless the securities of the company are quoted on a recognised stock exchange (by virtue of section 209(e) ICTA).

By virtue of section 54 ICTA, interest payable in respect to a contract debt (i.e. not a money debt) will not be deductible unless it is wholly and exclusively incurred for the purposes of the trade of the company in question.

b) Withholding tax

Notional cash pooling possibly reduces withholding tax issues, as interest is likely to be treated as interest from the bank rather than from another member of the group. Under UK legislation, there is no withholding tax on payments to UK banks and to other UK corporates.

Under physical cash pooling arrangements, intra-group loans will arise on which interest will be payable by one group member to another. One would need to look at the relevant tax treaties to see if tax needs to be withheld and whether this can be reduced by making a treaty clearance application.
c) Thin capitalisation rules
HM Revenue and Customs (“HMRC”) generally operate on the basis that they do not like companies being funded by debt from related third parties beyond the level a third-party bank would be willing to contemplate.

Since 1 April 2004, the UK thin capitalisation legislation has been a subset of the UK transfer pricing rules. As a result, much of the basic transfer pricing approach carries over to thin capitalisation cases and, like transfer pricing, the thin capitalisation provisions need to be interpreted in accordance with the Organisation for Economic Cooperation and Development guidelines.

The UK’s application of thin capitalisation relies upon the arm’s length principle – how much the borrower would have been able to borrow from an unconnected third party. In applying this principle, it is necessary to consider the borrower in isolation from the rest of the group.

This does not, however, require actual assets or liabilities to be disregarded. For example, shares in subsidiaries and intra-group loans should be taken into account in calculating borrowing capacity to the same extent that they would be taken into account by an unconnected lender. In the case of shares, the practical effect of this rule is thought to be that all assets and liabilities in direct or indirect subsidiaries should be taken into account. Equally, in-come or expenses arising from intra-group trading contracts should not be disregarded.

HMRC typically accept a 1:1 ratio of debt to equity but will accept a higher gearing if market practice allows.

Under the transfer pricing rules, where a loan exceeds the amount that would have been provided by an unconnected lender, the interest on the excessive part of the loan is disallowed as a tax deduction for the borrower. Nevertheless, the excessive interest can be paid without deduction of tax. This is because the rules provide that the excessive interest is not treated as interest for tax purposes, and so the condition in section 874 of the Income Tax Act 2007 to deduct tax at source is not met.

Furthermore, under the distribution rules, where an interest payment (or part of it) is re-characterised as a dividend there is also no requirement to withhold tax in respect of it.
d) Cap on interest deductibility
UK resident companies will see their tax deductions for interest payments restricted by reference to their worldwide group’s overall external finance costs.

e) Value added tax
Under Council Directive 2006/112/EC (the “VAT Directive”), with effect from 1 January 2010 the general position with regard to transactions involving services supplied to business customers was reversed, such that they are deemed to take place in the jurisdiction where the recipient belongs or has a fixed establishment. This change has been implemented under UK law in section 7A of the Value Added Tax Act 1994 (“VATA”) and does not change the position in relation to services currently listed in schedule 5 VATA which, for business customers, were always deemed to be supplied where the recipient belonged and include banking and financial services, such as treasury services being performed by a parent.

Where services supplied in the UK are received by a UK taxable person from a person established outside the UK, the reverse charge mechanism will apply so that the recipient may have to account for VAT on his receipt of the services. The reverse charge mechanism should not, however, result in any VAT in this case because financial services are generally exempt in the UK.

There is no stamp duty or other indirect taxes that will be payable on the principal or on the return of the cash transaction.
Contacts

Albania
Mirko Daidone
E  mirko.daidone@cms-aacs.com

Malvina Mulliri
E  malvina.mulliri@cms-aacs.com

Austria
Daniela Karollus-Bruner
E  daniela.karollus-bruner@cms-rrh.com

Belgium
Cédric Guyot
E  cedric.guyot@cms-db.com

Adrien Lanotte
E  adrien.lanotte@cms-db.com

Bulgaria
Atanas Bangachev
E  atanas.bangachev@cms-cmno.com

Gentscho Pavlov
E  gentscho.pavlov@cms-rrh.com

Chile
Ramón Valdivieso
E  ramon.valdivieso@cms-ca.com

China
Dr Ulrike Glueck
E  ulrike.glueck@cmslegal.com

Kevin Wang
E  kevin.wang@cmslegal.cn

Croatia
Gregor Famira
E  gregor.famira@cms-rrh.com

Czech Republic
Lucie Hallóová
E  lucie.halloova@cms-cmno.com

Ivana Meňhartová
E  ivana.menhartova@cms-cmno.com

Helen Rodwell
E  helen.rodwell@cms-cmno.com

France
Alain Couret
E  alain.couret@cms-bfl.com

Germany
Alexandra Schluck-Amend
E  alexandra.schluck-amend@cms-hs.com

Hungary
Eszter Kalman
E  eszter.kalman@cms-cmno.com

Italy
Paolo Bonolis
E  paolo.bonolis@cms-aacs.com

Luxembourg
Julien Leclère
E  julien.leclere@cms-dblux.com

The Netherlands
Eduard Scheenstra
E  eduard.scheenstra@cms-dsb.com
Peru
Juan Carlos Escudero
E juan.carlos.escudero@cms-grau.com

Enrique Silgado
E enrique.silgado@cms-grau.com

Poland
Małgorzata Chruściak
E malgorzata.chrusciak@cms-cmno.com

Dariusz Greszta
E dariusz.greszta@cms-cmno.com

Portugal
João Caldeira
E joao.caldeira@cms-rpa.com

Romania
John Fitzpatrick
E john.fitzpatrick@cms-cmno.com

Rodica Manea
E rodica.manea@cms-cmno.com

Horea Popescu
E horea.popescu@cms-cmno.com

Russia
Konstantin Baranov
E konstantin.baranov@cmslegal.ru

Hayk Safaryan
E hayk.safaryan@cmslegal.ru

Serbia
Mihajlo Matković
E mihajlo.matkovic@cms-rrh.com

Marija Tešić
E marija.tesic@cms-rrh.com

Slovakia
Petra Čorba Stark
E petra.corba-stark@cms-cmno.com

Slovenia
Irena Šik Bukovnik
E irena.sikbukovnik@cms-rrh.com

Ivan Kranjec
E ivan.kranjec@cms-rrh.com

Spain
Abraham Nájera Pascual
E abraham.najera@cms-asl.com

Switzerland
Alain Raemy
E alain.raemy@cms-vep.com

Turkey
Dr Döne Yalçın
E doene.yalcin@cms-rrh.com

Sinan Abra
E sinan.abra@cms-rrh.com

Ukraine
Olga Belyakova
E olga.belyakova@cms-cmno.com

Anna Pogrebna
E anna.pogrebna@cms-rrh.com

United Kingdom
Keith Ham
E keith.ham@cms-cmno.com
CMS Legal Services EEIG (CMS EEIG) is a European Economic Interest Grouping that coordinates an organisation of independent law firms. CMS EEIG provides no client services. Such services are solely provided by CMS EEIG’s member firms in their respective jurisdictions. CMS EEIG and each of its member firms are separate and legally distinct entities, and no such entity has any authority to bind any other. CMS EEIG and each member firm are liable only for their own acts or omissions and not those of each other. The brand name “CMS” and the term “firm” are used to refer to some or all of the member firms or their offices.

CMS locations: