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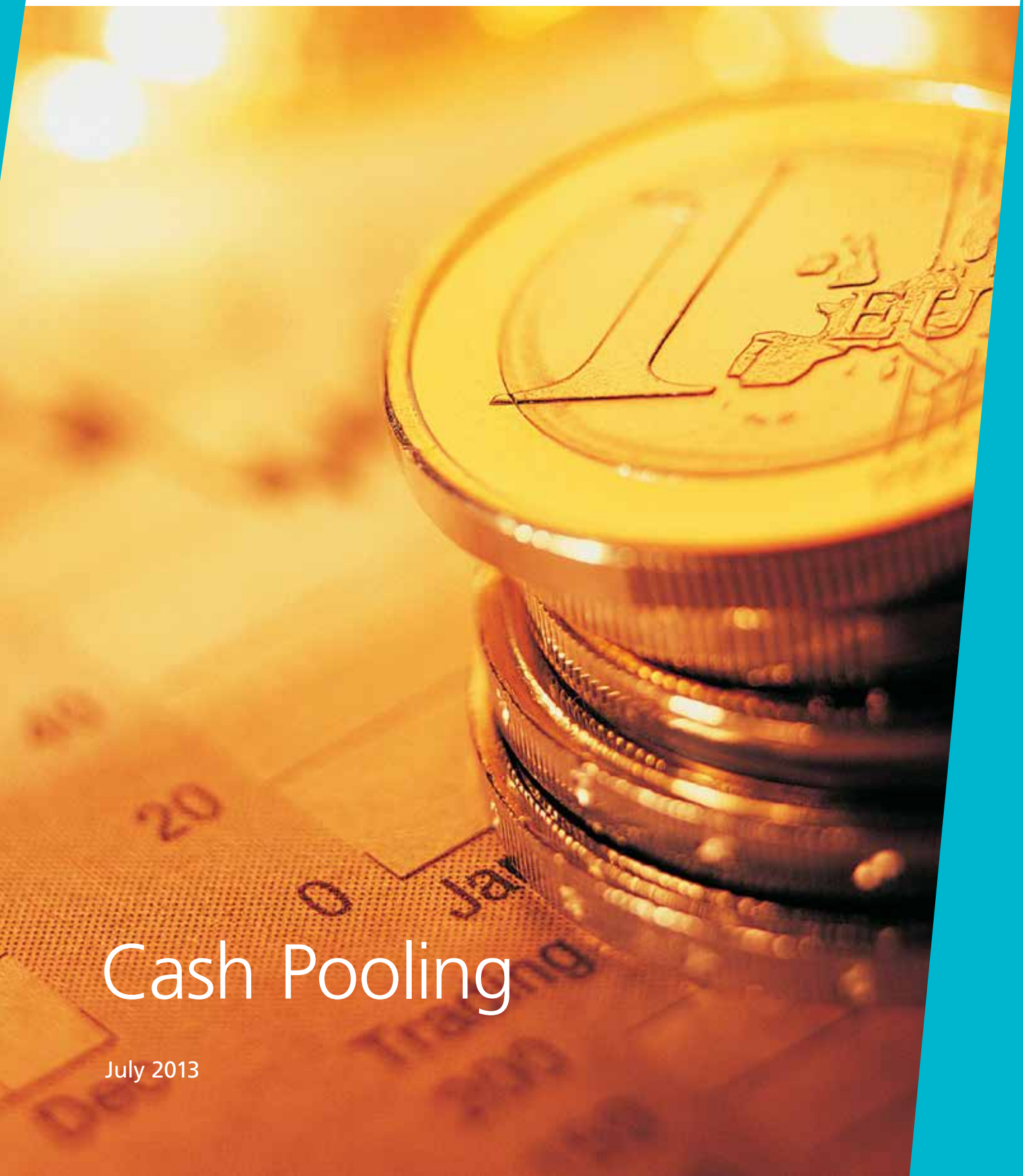

Cash Pooling

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Introduction

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

Under a cash pooling arrangement, entities within a corporate group regularly transfer their surplus cash to a single bank account (the "master account") and, in return, may draw on the funds in that account to satisfy their own cash flow requirements from time to time. The master account is usually held by the parent company or by a "treasury company" established specifically for this purpose. Depending on the type of cash pooling arrangement, the participating entities may transfer either their entire cash surplus ("zero balancing"), or cash exceeding a certain surplus level ("target balancing").

In general, all entities participating in the cash pooling arrangement will be liable for any negative balance on the master account, irrespective of the amount they have contributed.

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

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

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

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

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

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

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Austria

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1. Legal framework for cash pooling

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 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 52 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 a 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 between 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 made the same deal in the same circumstances with a third party not affiliated to the company.

The general terms and conditions of banks in Austria often require the grant 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 such 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.

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 fictive period for the satisfaction of debt 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, then 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 unclear whether 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. Furthermore, 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 shareholders' resolutions).

c) Extent of due diligence to be conducted by the pool bank
In case 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 has 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 strong suspicion of disguised unlawful distribution.

d) Further risks
Under Austrian law, cash pooling may trigger stamp duties in the amount of 0.8% of the loans granted. Furthermore, it is unclear to what extent 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.

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. Furthermore, 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.

Belgium

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Although there are no specific provisions of 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 "interest 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 "interest 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 of 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 interest of the group as a whole does not endanger the existence of the company providing the support and is only provided temporarily.

However, the principle of "interest of the group" is subject to the following limits:

— the group cannot forfeit one of its subsidiaries in the sole interest 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 interest of the group and that 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 damages suffered by third parties are 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 the 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 / or 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 may not be compromised for the benefit of the interest 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 their 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, then 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 allows 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), then it is absolutely necessary that the cash pooling agreement specifies 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 interest of the Belgian company.

5. Rules restricting companies' indebtedness for creditor protection purposes

Although there are no specific rules restricting the extent of a Belgian company's indebtedness (i.e. no thin capitalisation rule), 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.

Bulgaria

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1. Legal framework for cash pooling

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

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

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

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

— is able to seek repayment of any funds it has contributed to the cash pool; and is able to realise a benefit from partaking in the cash pool (such as preferential interest rates or easy access to liquid finance).

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

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

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

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

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

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

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

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

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

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

d) Other matters to be considered
— Parent-subsidiary loans to insolvent participants will rank last in a winding-up
— Intra-group security provided by a participant in the 3 years prior to becoming insolvent may be declared invalid, depending on the circumstances

2. Legal structure and reduction of risks

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

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

(2) Right to information
The companies participating in a cash pooling arrangement should seek to have the right to up-to-date information on the liquidity and solvency of the other participating companies. An efficient and effective way of ensuring this may be for the cash pooling agreement to contain an obligation that the parent company provide the participating companies with monthly consolidated financial statements for the group as a whole, whilst each participating company should have the right to inspect the cash pool accounts.

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

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

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

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

(1) Termination rights of individual participating companies

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

(2) Joint and several liability and security

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

(3) Liability on a sale of a group company

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

3. Tax issues

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

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

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

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

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

— the amount of the loan exceeds the amount of the subsidiary's equity;
— the repayment of the principle or the payment of the interest is not subject to fixed terms;
— the repayment of the principle or the payment of the interest or the amount of the interest depends on the amount of the profits of the subsidiary; or
— the repayment of the loan is subject to the payment of other debts or the payment of dividends.

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

— the relevant interest expense will not be deductible from the profits of the subsidiary for corporation tax purposes;
— the subsidiary will be liable for a penalty amounting to 20% of the hidden distribution;
— the income from the distribution will not be eligible for deduction from the parent company's profits for corporation tax purposes (it normally would if the subsidiary is based anywhere within the EU); and
— the distribution will not be eligible for an exemption from withholding tax (it normally would if the parent is based within the EU).

c) Thin capitalisation

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

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

China

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1. General Legal Framework

In China, there is no specific legislation on cash pooling. Due to foreign exchange control in China, both inflow and outflow of foreign exchange in China are still heavily regulated. As a result, it is not possible to set up cross-border cash pooling arrangements between companies in China and their offshore affiliates.

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.

Futhermore, direct inter-company lending is prohibited by the PRC General Provisions of Lending (the "GPL"). Therefore, in China the cash pooling arrangement can only be achieved within a group of affiliated companies through an entrustment loan framework.

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 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 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 equalling such debit balance from the head account of the Concentration Leader to the account of the concerned participating company via entrustment loan arrangement.

b) Foreign Exchange Cash Pooling Arrangement within China

The Provisions on Administration of Centralized Management of Foreign Exchange Funds between Internal Members of Enterprises in China issued by the State Administration of Foreign Exchange (the "SAFE") on October 12, 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 (1) the parent company, (2) subsidiaries in which the parent company holds more than 51% of the equity interests, (3) companies in which the parent company and the subsidiaries individually or jointly hold more than 20% of the equity interests, (4) 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 (5) 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 the 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) Cross-border Lending

Due to foreign exchange control in China, it is not permissible to set up cash pooling arrangements between companies in China and their offshore affiliates. In accordance with the Circular on Foreign Exchange Control Issues Relevant to Overseas Loans Granted by Enterprises in China, which came into effect on 1 August 2009, it is only possible for a company in China to grant a loan to its overseas wholly-owned subsidiary or an overseas enterprise in which it has equity interests.

There is one exception in Shanghai Pudong New Area, Shanghai, which allows the group members (incorporated in Pudong New Area) of a foreign transnational company to lend money to overseas affiliates, i.e. not only their overseas subsidiaries, in accordance with the Operating Rules for the Foreign Exchange Administration of Outbound Lending by Foreign Transnational Companies in Pudong New Area (the "Pudong Overseas Lending Rules") issued by the SAFE Shanghai on 8 March 2010. For the purpose of the Pudong Overseas Lending Rules, the term "foreign transnational company in Pudong New Area" refers to a foreign invested holding company which has member companies in both Pudong New Area and outside China, in which an overseas parent company ultimately holds the controlling shares.

Please note that the Pudong Overseas Lending Rules impose some crucial criteria on overseas lending, which include, inter alia, the following:

(1) Both the lender and the borrower have been duly incorporated and their registered capitals have been contributed in accordance with their respective contribution schedules;
(2) The number of the member companies in China is not less than 3;
(3) The term of the loan is not more than 2 years;
(4) The lender will additionally meet the following requirements: (a) the ratio of its foreign exchange receivables of the previous year to its total foreign exchange assets will be lower than the normal or average level of foreign invested enterprises of the same industry of the previous year; (b) in the previous year its foreign exchange settlement amount was larger than its foreign exchange purchase amount; or if the foreign exchange purchase amount was larger than the settlement amount, the balance is lower than the normal or average level of the foreign invested enterprises of the same industry of the previous year; and (c) its owner's equity interests will not be less than USD 30 million and the ratio of the net assets to the total assets will not be less than 20%;
(5) The balance of the outbound foreign exchange lending will not exceed the aggregate amount of the part of profits in the previous year that has been distributed but has not yet been remitted abroad to the foreign investor plus the undistributed profit in proportion to the investment of the foreign investor.

2. 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 authorized 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 willl 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.

b) Restrictions for Listed Companies
Under the Circular (Zheng Jian Fa (2003) No. 56) issued by the China Security Regulatory Commission and the PRC State-owned Assets Supervision and Administration Commission, a listed company in China is forbidden from lending 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.

3. Tax Issues

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

(1) For loans borrowed from financial institutions by a non-financial institution, the interest is deductible on actual basis;
(2) 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 may be treated as dividend distribution for tax purposes, if:

(1) such interest exceeds the interest on a similar loan with the same term as borrowed from a financial institution; or
(2) the total debt from related parties to the equity ratio exceeds 2:1 for a non-financial institution (5:1 for a financial institution).

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 Capitalization Rules
The interest rates and the terms of the intra-group loans is 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 CIT (Corporate income tax) purposes. The interest expenses refer to the interest, the guarantee fee, the mortgage fee, and other expenses with the nature of interests.

d) Business Tax ("BT") and Surcharges
Under the PRC Provisional Regulations on Business Tax, the interest income is subject to BT of 5%. In addition, surcharges are levied on the actual BT payment. 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, education surcharge of 3% and local education surcharge of 2%, each calculated on the basis of BT.

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.

Croatia

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1. Legal framework

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

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

Please note that as of 1 January 2011 restrictions (e.g. permission required from the Croatian National Bank) for opening of a bank account of a Croatian entity with a foreign bank (meaning a bank with its seat outside Croatia) have been abandoned. However, there is still an obligation to inform the Croatian National Bank about transactions entered into with non-Croatian entities and foreign account balances.

b) Shareholders' loan provisions
As cash pooling is, by definition, always an intra-group loan, legal requirements as to shareholders' loans may apply. Certain restrictions as to shareholder loans should therefore be considered. For instance, when a company requires additional equity and the shareholder, instead, grants a loan to the company, such shareholder loan shall (in the company's insolvency) be subordinated to third party loans. If such loan is 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.

2. Types

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

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

a) Intra-company cash pooling
It is common in Croatia 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 such instance cash pooling may significantly reduce costs if there are differences between the accounts (i.e. some have net credit positions whilst others net debit positions). However, it should be noted that there are risks and liabilities if the profits of the participating companies are 'silently' transferred within the group.

3. Liability risks

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

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

Indeed, unless the risks are outweighed by the benefits, no director should enter into a cash pooling agreement where the company does not receive an adequate remuneration for its liabilities or contributions. Of course, it is unlikely that any participating company would file a claim against the directors of another participating company (as they are likely to all be members of the same group), but there are instances where creditors of a subsidiary could directly claim damages from the directors of the subsidiary, predominantly in insolvency scenarios.

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

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

4. Mitigating the risk

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

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

b) Agreement between business enterprises (in Croatian "poduzetnički ugovor")
The Croatian Companies Act envisages a specific type of agreement between business enterprises (an "ABE") whereby one company undertakes to transfer all or part of its profits to another company. Shareholders' meetings should approve an ABE with a qualified majority of votes. Therefore, when drafting a cash pooling agreement, provisions referring to ABEs should be considered.

5. Tax issues

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

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

Czech Republic

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

1. Company Legislation

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

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

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

2. Banking Legislation

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

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

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

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

3. Liability

a) General
Breaches of corporate legislation may result in both criminal and civil liability for the officers of the relevant company and, in certain cases, the shareholders as well. In most cases, such liability arises from the commission of a "crime" against the property or other economic interest of a company by the officers of that company, and is not specific to cash pooling transactions. Breaches of relevant banking legislation carry liabilities in the form of fines for the companies who breach them.

Additionally, since 1 January 2012 the committing of a property or economic criminal offence may also result in criminal liability for the company itself. The new act on criminal liability of legal entities and proceedings against legal entities penalises illegal acts of all legal entities, which may be subject to fines of up to EUR 60,000,000 as well as other sanctions including dissolution of the entity, loss of its business licence and / or 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

The following actions are recommended for all Czech entities intending to participate in a cash pooling arrangement.

— Approval of the general meeting of shareholders should be obtained for each entity's entry into the cash pooling arrangement. If approval is obtained for the general framework within which the individual loans will be made then only one general shareholder meeting will be needed to approve all the as yet undocumented loans to be made.
— Articles of association of each Czech entity who will be a party to the arrangements should be reviewed, to ensure compliance with any additional requirements contained therein concerning any restrictions on indebtedness of the entity or on the types of agreements the entity is permitted to enter into, as well as any special conditions which may need to be fulfilled prior to entry into a cash pooling arrangement.

— Obtaining an expert valuation of the cash pooling arrangements by a court appointed expert to evidence arms' length terms of the transaction. This can be done by petitioning a Czech court to appoint and approve a registered expert to produce a valuation of the cash pooling arrangement for each Czech entity that intends to participate.
— Ensuring each entity complies with its filing obligations to the Czech National Bank by notifying it of the form, content and general conditions of the credit agreements to be used in the cash pooling arrangement, and of the nature of any local or foreign bank accounts to be used. This notification obligation should be fulfilled within 15 days of the date of the first payment under the arrangement taking place.

5. Tax considerations

a) Interest deductibility

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

Generally, the parties are free to determine a rate of interest that will be charged on loans under the cash pooling arrangement, but regard should be given to the thin capitalisation and related parties' transactions legislation described above when deciding on what rate of interest should be charged. Specifically, the requirement for the transaction to be at arm's length will necessitate the provision of such loans at commercial rates of interest prevailing in the loans market for unaffiliated parties. If this is not ensured, the Czech Tax Authority may order that an adjustment be made to the taxable income of any entity under such an arrangement. These adjustments take theform 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 guidelines provide a useful framework for settling price valuations by explaining in considerable detail how to apply the arm's length principle. Generally, the relevant taxpayer is only required to show that the valuation method used delivered a reasonable "arm's length" result and is not obliged to justify its selection. It is also possible to obtain a binding assessment of the Czech Tax Authority, confirming the chosen rate of interest satisfies the arm's length requirement. This, however, must be done prior to the entry into the cash pooling arrangement, as the Authority will not issue any retrospective assessment.

b) Withholding tax

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

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

— the beneficial owner of the interest is a company related to the paying company and it is residing in another EU Member State; and
— a statement of exemption has been issued by the Czech Tax Authority.

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

— notification of a relevant EU tax authority that the foreign company is tax resident in that country;
— evidence that the foreign entity has an acceptable legal form under EC regulations;
— evidence that the participating companies are related parties;
— a description of the methodology used to set the rate of interest on loans under the cash pooling arrangement; and
— evidence that the recipient of the interest is the ultimate beneficial owner of it.

France

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1. Legal framework for cash pooling

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 to banks in France under the Monetary and Financial Code *(Code monétaire et financier)*. However, Section L 511-7,I,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 beyond 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 interest. 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 / or 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 interest 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 Cour de cassation (*Chambre Criminelle de la Cour de Cassation* – French Supreme Court) set out three criteria to be considered when deciding whether cash advances between companies within the same group will 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 complies 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 Cour de cassation (*Chambre Criminelle de la Cour de Cassation* – 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 notably those of the *Cour de Cassation* (French Supreme Court), is to set a high standard for compliance in respect of the aforesaid provisions.

3. The reduction of the 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 interest 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 sub-accounts 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, 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.

Germany

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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 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 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 may 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 overindebtedness (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).

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 overindebtedness), 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 overindebtedness (§ 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.

d) Hidden distribution of profits
Profits may only be distributed to shareholders subject to a formal shareholders' 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 make 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, down-stream 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. 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.

(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, 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 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 shareholders' 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 sub-balance of the company or if payments are made even though there is a sub-balance or the company is illiquid. It is not possible for the shareholders to vitiate this liability in the name of the company, neither through shareholders' resolution, nor otherwise. However, share-holders 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 shareholders' 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.

Therefore the participating companies should 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.

(ii) 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.

(iii) 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.

(iv) Raising capital

A possibility to avoid liability of the directors and to minimize the risk that shareholders will have to fulfil the initial contribution twice when raising capital is to avoid that the parent or treasury company and the recipient of the capital are identical. Payments into a bank account with a negative balance should also be avoided.

c) Cash pooling agreements with the individual participating companies

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 lien-creating provisions of the standard terms and conditions. If this is not possible, then the company's liability should be restricted at the very least to the lesser of (i) the actual amount of funds 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 € 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 license 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.

Hungary

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1. Legal issues

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

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

b) Hungarian company law: the maintenance of share capital
Pursuant to Hungarian company law, a Hungarian company's equity must exceed the minimum level of registered share capital required for a company of its form, as set by statute. If it does not meet this requirement in two consecutive years, known as a situation of "negative-equity", then the shareholders should provide enough equity to ensure that it does (and within a certain deadline). Alternatively, the company should decide on its transformation into another form of company or on its termination without legal successor. According to a fairly recent court decision, if the deadline for providing equity has passed, the shareholders may 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 Kft (limited liability company) has fallen to below half of the amount of its registered share capital (due to losses). The subsequent members' meeting must take rectification measures (e.g. make additional capital payments or decrease the registered capital). Parent companies should therefore be concerned that the cash pooling arrangement does not result in subsidiaries overextending their contributions at the expense of the equity on their balance sheets.

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

c) Liability
As a general rule, the directors of a company involved in cash pooling are to 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:

(1) Piercing of the corporate veil

If a limited liability company or company limited by shares is terminated without legal successor, a shareholder cannot rely on its limited liability if it has misused such protection, and the same applies if a shareholder holding at least 75% of the voting rights conducts, as shareholder, a business policy permanently disadvantageous to the company. Therefore, 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 permanently disadvantageous to the company 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 then the court may declare that the former majority shareholder who transferred his shares within 3 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 been still 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.

Liability of majority shareholder similar to the above applies with respect to forced annulment of a company (which means a solvent dissolution) when the court annuls the company notwithstanding that the company left behind unpaid debt.

(2) Directors' liability for damages

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

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

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

(3) Director's liability for debts

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

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

2. Tax issues

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

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

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

c) Corporation tax
Any income earned from interest earned in a cash pool forms part of the general accounting pre-tax profits of a company, and is taxed at the rate of 10% (up to an overall profit level of HUF 500 million,(approx. EUR 1.7 million) or 19% (on the excess profit).

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

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

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

e) VAT rules
In respect of services supplied to businesses, the place of supply is the place where the customer is established.

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
The law came into effect on 1 January 2013. Such financial transaction tax applies – inter alia – to all wire transfers, at a rate of 0.1% of the transaction value, maximized at HUF 6,000 (EUR 21) per transaction. The tax is payable by the financial institution which can then pass the cost onto 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.


EURO

Italy

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Although there are no specific provisions governing cash pooling arrangements 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, it must fall within the company's purpose as set out in the articles of association. It is therefore important that the social purpose 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 and / 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 and / 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 damages or losses they may suffer as a consequence; and
— the relevant agreement(s) being declared void.
It should also be noted that where an Italian company contributes funds and / 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 and / 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 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 agreements between the participating group companies must enable the Italian participating company to easily and promptly recover funds transferred to the various other participating companies (or the cash pooler) under the arrangement.

As a result of the above the directors and the infernal auditors (membri del Collegio Sindacale) of the Italian participating company must carefully consider (i) whether the company has an interest (direct or indirect) in entering into the cash pooling arrangement and in providing any connected guarantee; and (ii) the circumstances in, and conditions on, which the relevant arrangements can be entered into.

Directors who have a – even 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 in 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:

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

If either of the above circumstances apply:
— 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, then any repayment made in respect of such loans by the Italian borrowing company in the year preceding the declaration of insolvency r 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 and / or insolvency proceedings, 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 the 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 arrange¬ment – the extent of the risk that the Italian company will be unable to recover sums it contributes to the cash pool (e.g. in the case of insolvency of the group company which holds the master account).

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 in 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 such 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 such 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 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 interest 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 means 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 such 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 as regards the matters discussed above. 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, then the resolution must set out in detail the reasons and benefits which justify the decision taken and must analyse the pros and cons of such decision (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, then 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 of the Bank of Italy, the management of the cash liquidity among companies belonging to the same group which is effected through a pooler acting with the mere purpose of optimizing the management of group liquidity, cannot be considered as payment service according to the definition of Directive 2007 / 64 / EC, and therefore, no authorisation / communication is requested to act as pooler of the group cash pooling system. Such exemption is granted on the assumption that the liquidity management is limited to the group companies and no transfer of funds is effected towards third parties not belonging to the group.

With the purpose to survey and draft the relevant statistic reports on the international transfer of money, the Bank of Italy established the so-called "direct reporting" system which relies on the data entered by certain companies, periodically selected by the Banks of Italy, which are requested to provide information concerning transactions, international investment position and non-financial transactions, together with details relating to companies participated by the resident company themselves.

As regard the transfer of cash involving an Italian company and a foreign counterparty exceeding EUR 10,000, such transactions are subject to the tax reporting to the custom office.

In addition, any transfer of money effected through Italian banks and/or financial intermediaries is subject to statistic communication as well as to anti-money laundering reporting directly made by the relevant banks and/or financial intermediaries. The threshold triggering the relevant reporting duties amount to EUR 15,000.

Luxembourg

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Cash pooling triggers banking regulatory law and company law. From a tax perspective, issues such as withholding tax, thin capitalization rules, tax rates, incentives and transfer pricing shall be pointed out. Luxembourg advanced tax ruling system guarantees upfront the tax treatment of transactions.

1. Social interest

Under Luxembourg law, directors / managers 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.

As a starting point, if the transaction is entered at arm's length terms, with an appropriate remuneration for the risks involved, the company derives a direct benefit from such transaction which would then be in its corporate benefit.

In the absence of any such "direct benefit", one would have to examine whether the corporate interest of the company in entering into the transaction could be justified by the "group interest".

There is no specific Luxembourg law governing groups of companies, consequently each company is considered as a separate entity and the group has no legal personality itself. In the absence of case law regarding the interest of the group of companies, directors cannot enter into disproportionate operations endangering their company on the basis of the "best interest of the group". A certain contractual balance in intragroup transactions must be maintained.

By relying on the considerations derived from case-law, one could justify the transaction in the name of the "group interest" if

(i) there is a common benefit to the parties involved in the light of the group policy, including also a direct or indirect economic advantage for the company,
(ii) the transaction does not exceed the company's financial capacity (it should not be, in terms of the amounts involved, disproportionate as compared to the financial means of the company and the benefits derived from entering into the transaction), and
(iii) the risks of the transaction should be evenly apportioned among the group's companies (if there is more than one, so as not to upset the balance between them).

If the transaction is not found to be in the corporate interest of the company, its directors / managers may have their liability committed (i) towards the company (as the company has granted a management mandate to the latter), as well as (ii) towards third parties on the basis of an infringement of the company law or of the articles of association of the company or general tort liability rules – it being understood that third parties must have suffered a prejudice to have a cause of action.

The absence of corporate interest may also lead to the criminal liability of the directors / managers or de facto directors / managers of the company using 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 entail the criminal liability of the management to be committed.

2. Capital maintenance rules and directors / managers' obligations

No distribution to shareholders or financial assistance to third party may be granted if it results in the reduction of the assets of the company below the aggregate of the subscribed capital plus the reserves which may not be distributed under the law and the articles of association. However such circumstance may occur in certain cases permitted by the law such as investment companies with fixed capital or certain public limited liability companies. In such cases the directors / managers will include a note to that effect in the annual accounts.

3. Corporate capacity – objects clause

The articles of association state the object of the company and may limit the authority of the company's directors / managers. The company and its directors / managers carry out activities within the scope of the company's object. Any action outside the scope of the company's object cannot be undertaken and, if it is undertaken, shall trigger the directors / managers' liability towards the company and third parties.

4. Circular issued by the Luxembourg direct tax authorities

Luxembourg Income Tax Law (the LITL) 164 / 2 dated 28 January 2010 (the Circular)

The Circular addresses most of the issues concerning the tax treatment of companies carrying out intra-group financing transactions.

According to it, loans or advanced money granted to associated enterprises, refinanced by funds and financial instruments such as public offerings, private loans, advanced money or bank loans is considered to be an intra-group financing transaction as defined by the OECD and subject to the following provisions:

1. The at arm's length principle, as defined in article 9 of the OECD Model Tax Convention on Income and on Capital and the OECD Guidelines, will determine the transfer prices between related companies carrying out cross-border transactions.

2. Article 164 (3) of Luxembourg Income Tax Law (the LITL) provides that a hidden profit distribution occurs specially when a shareholder, or an interested party receives, either directly or indirectly, benefits from an enterprise or an association which he normally would not have gained if he had not been a shareholder, or an interested party. Such profit distribution is considered in the taxable base of the company or association. Furthermore the at arm's length principle should be included in domestic law.

3. Paragraph 171 of the General Tax Code states that taxpayers must be able to sustain the data reported in their tax returns, containing the transfer pricing of controlled transactions.

4. Determination of the arm's length price for intra-group financing companies

The granting of loans between intra-group financing companies should be equivalent to the loans granted to an independent financial institution subject to the supervision of the "Commission de Surveillance du Secteur Financier" (the CSSF).

Before granting loans or advancing money, financial institutions examine the risks involved. As part of their examination, they study the financial statements of the borrower in order to assess the financial risk involved in the transaction. Moreover the credit risk is assessed on the basis of the terms and conditions of the loan agreement and on basis of the result of the statement of the risk.

An extra fee for solvency requirements may be added on the basis of the lender's solvency or on the solvency of another group entity which may act as guarantor. In this respect, a group financing company must have sufficient equity in order to if necessary adopt the risks related to its business and must acquire such risks if they were to materialize.

Group financing companies carrying out intragroup lending transactions should carry out a risk assessment before granting a loan to an associated enterprise as if they were independent service providers. They should also take into account any other element which may weigh the evaluation of their transfer prices.

The Netherlands

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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 fiscal, finance and insolvency matters relating to cash pooling (with the exception of a brief discussion on the fraudulent act (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 objects[2], 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 the 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.

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, then 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

[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).

[3] Supreme Court, 18 April 2003, JOR 2003 / 160.

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, then 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 provided [4], 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 there appears to be an imbalance between the commercial benefit gained by the company and the detriment it would suffer if the guarantee was called upon, then the company (or its insolvency trustee) will be able to contest the guarantee's validity. This is so, 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 benefit required. Therefore, it cannot be ruled out that even if there is a 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.

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 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 interest instead of the interest 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 the entering into cash pooling arrangements. This representative may also be a member of the Board.

[4] Supreme Court, 20 September 1996, NJ 1997, 149 (Playland) and 16 October 1992, NJ 1993, 98 with annotation Maeijer.

[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 of 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.

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.

d) Fraudulent act (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
In general Dutch banks are only prepared to offer cash pooling arrangements on competitive conditions if this does not affect their solvency. This applies in particular in the case of notional cash pooling since in that case the various credit and debit balances stay in place and there is only a virtual set-off in order to calculate interest.

Under the Rules solvency requirements for the credit risk (Regeling solvabiliteitseisen voor het kredietrisico) of the Dutch Central Bank banks are allowed to set off credit and debit balances of companies of the same group, if the various credit balances will be pledged by separate pledge agreement to the bank as security for the debit balances.

A separate pledge agreement is not necessary if general conditions apply in the relation between the bank and its client(s) which already provide for such a pledge. The General Banking Conditions 2009 of the Dutch Banking Association include an arrangement on the pledge of (inter alia) credit balances. Most banks apply the General Banking Conditions or use their own general conditions which often are in broad outline more or less similar and normally will always include the pledging of credit balances.

In the event the notional cash pool is arranged for affiliated or non affiliated companies the credit balances can also be compensated with the debit balances if the credit balances will be pledged to the bank as security for the debit balances or if certain other arrangements are agreed upon which offer the bank similar protection.

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 the 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, then the parent company may have to undertake actions to avoid or limit the extent of such consequences (including but not limited to filing for insolvency). 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 this ground 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[10].

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

[10] Supreme Court of the Netherlands, 21 December 2001, JOR 2002, 38 (Hurks II) and 12 June 1998, NJ 1998, 727 with annotation Van den Ingh (Coral-Stalt).

Poland

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

1. General legal framework

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

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

a) Insolvency issues and capital maintenance
A general risk of participating in cash pooling is that a company may become insolvent if the monies transferred to the master account are not invested properly or are not transferred back to the company. This may especially be true if the insolvency of one of the participants has an adverse effect on the functioning of the other participants (for example, it may be that the insolvent company had 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, then the creditors may demand that such actions are declared ineffective.
— If a company declares insolvency within two years of a loan being granted by a shareholder to the company, the loan may be regarded as a capital contribution to the company by the shareholder. Therefore, in a cash pooling structure, any transfer of funds by a parent company to the master account may be risky if the subsidiary removes the parent's funds and later (within two years) the subsidiary becomes insolvent.

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 insolvency (if the company fails either or both of the two insolvency tests applicable under Polish law).

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 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 someone of their professional character and activity, and to avoid any situations that may lead to the company's insolvency. Therefore, their actions should be compliant with statutory laws and the provisions of the company's articles of association. The directors of a company that proposes to enter into a cash pooling arrangement will therefore need to evaluate the risks of damage to the company against any benefit it may accrue; a failure to make such proper consideration may put the directors in breach of their duties.
— An example of where liability may arise is when a company has become insolvent as a consequence of a transfer of funds to the cash pool, such funds being swallowed as a result of, for example, another participant's insolvency. In such instance, the members of the management board may be held personally liable if they fell short of the duty upon them to ensure repayment of the funds.
— In addition, management board members are, in certain situations, jointly and personally responsible with a company for its liabilities.

As a general rule, the above liability may not be excluded or limited; in particular, the board may not seek to rely on a resolution of a shareholders' meeting granting directors discharge from their duties, or claim that the company waived any claims in respect of the activities undertaken by the board.

b) Liability of a parent company

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

3. Banking law and foreign exchange regulations

Cash pooling is 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 exempt from those reporting obligations altogether).

4. Tax issues

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

to avoid a dispute with the tax authorities, applying for an individual ruling is always recommended.

Withholding tax

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

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

Another basis for exemption could be the European Parents-Subsidiary Directive. However, the directive will not be fully implemented into Polish law until 1 July 2013.

Thin capitalization

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

Portugal

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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 ruled 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 in 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 relation 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 issue 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 relation when 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 purpose
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, it 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). However, this type of structure may not be used for purposes of financial assistance (a target company may not provide funds or guarantee envisaging the acquisition of 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 interest of each company should prevail over the interest 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 conveyance of a shareholders' meeting in which shareholders are required to take convenient 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 (i) by way of a bonds issue is limited to the amount corresponding to twice its net equity and (ii) by way of an issue of commercial paper is limited to the amount corresponding to three times its net equity, but this restriction does not apply to borrowings of any other nature.

(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. 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 where 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 convey 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.

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 as against creditors of the company is concerned.

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

(e) Parent companies' liability
It may be that parent companies may be responsible 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 cover specifically 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 opening of insolvency proceedings.

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

Claims against the insolvent cash pool member will be filed with the administrator and subject to subordination should the lender be considered a person or company specially related with the borrower, that is to say, a company which is or has been in the past two years prior to the filing of insolvency proceedings 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 credits by the insolvent estate.

Acts carried out by the insolvent company to the detriment of the estate are subject to voidance and claw back by the administrator in the 2 (two) years prior to the filing for insolvency. Maliciousness is assumed if the other party is a person or company specially related with the insolvent. Redemptions of shareholder's loan made within 1 (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 of credit and payment of interest.

(b) Granting of credit – Portuguese Stamp Duty tax implications

Cash Management and / or Cash Pooling arrangements for periods of less than 1 (one) year exclusively to cover cash treasury needs, are exempt from Stamp Duty, as long as cash funding is granted upstream or downstream between a holding company and its affiliate company or cash funding is granted by a corporate holding more than 10% of the shareholding of the participated company benefiting from the downstream of cash treasury funds flows.

(c) Portuguese withholding tax (WHT) implications on payment of interest

(i) Domestic regime

Interest paid by a Portuguese resident entity to a non-resident Parent Company, will be liable to a Portuguese WHT which will be assessed at the domestic rate of 21.5%.

(ii) EU regime

Under the EU Interest and Royalties Directive, provided that the conditions required for its application are met, the domestic rate of 21.5%, is reduced to a 5% WHT until 30 June 2013. After this date interest paid under the terms of EU Interest & Royalties Directive will no longer be liable to WHT in Portugal. The EU Interest & Royalties Directive, as adopted by Portugal, may only be applied to interest paid to an affiliated company which is the beneficial owner of the interest. For this purpose, an affiliated company is defined as follows:

(a) if it holds a direct participation of at least 25% in the registered share capital of the other company; or
(b) if the other company holds a direct shareholding of at least 25% in its registered share capital; or
(c) when a third company holds a direct participation of at least 25% of the registered share capital of two entities, which makes them affiliated between them;

In all cases, the required 25% direct shareholding is required to have been held for at least a period of 2 (two) consecutive years prior to the WHT obligation. If the required 2 (two)-year period has elapsed after the WHT obligation the beneficiary will be able to apply for a reimbursement of the tax withheld in excess.

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 varying between 10% and 15%. Application of the reduced withholding tax rates, on an up-front basis, requires the completion of certain formal requirements aimed at certifying the eligibility of the beneficiary for the tax treaty protection provisions, which have to be completed up-front.

(d) Tax deduction of interest costs

Interest costs are generally deductible for Portuguese Corporate Income Tax purposes, as long as they are deemed necessary to generate the company's taxable profits and provided they are duly documented and supported. Non-deductible interest, if any, is not subject to recapitalisation.

(e) Portuguese thin capitalisation rules

Portuguese thin-capitalisation rules only apply to indebtedness with Non-EU entities. As such, Portuguese thin-capitalisation rules will not apply to finance arrangements put in place between a Portuguese subsidiary and its European parent or group company. Portuguese thin-capitalisation rules, when applicable, provide a Debt to Equity ratio of 2:1 above which interest will not be considered tax-deductible.

(f) 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.

(g) VAT aspects

Finance transactions, including cash pooling arrangements and current accounts, are VAT-exempt.

Romania

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Cash pooling is not a widely used financing method in Romania. Indeed, with the legal background fragmented, it appears that there are limited Romanian banks currently offering cash pooling arrangements. Nevertheless, cash pooling is likely to be utilised more in the future, given the benefits it can generate.

As such, cash pooling arrangements must be carefully structured in order to respect the relevant Romanian law, and minimise liability risks that may affect participating companies at both shareholder and director level.

1. Legal framework for cash pooling

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

a) Banking regulation

(1) Restrictions on lending

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

However, the long-standing position is that intra-group loans are not considered to be a professional lending activity, even though there is nothing specific in the law to state that. Nevertheless, it must still be noted that any business model involving the performance of activities similar to credit institutions or non-banking financial institutions is subject to the assessment and control of the

National Bank of Romania ("NBR"). The NBR is therefore ultimately vested with the power to determine whether or not an activity, such as cash pooling, is a lending activity performed on a professional basis.

(2) Statistical reporting to the NBR

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

In addition, any payments to, or collections from outside of, Romania that are equal to or in excess of EUR 50,000, as at the payment / collection date, and which are made or received by Romanian companies to / from non-resident companies, have to be reported to the NBR (for the purpose of drawing out Romania's balance of payments). Such a reporting requirement will clearly impact on cross-border cash pooling arrangements.

b) Corporate law

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

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

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

(2) Capital maintenance rules

The registered share capital of Romanian companies must meet the minimum amount required under Romanian law. If the board of directors 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 in to a "negative equity" situation, particularly if the contributions may not be recoverable (e.g. due to the insolvency of another cash pool participant).

In addition, Romanian company law strictly stipulates when the shareholders of a company are entitled to receive payments (i.e. dividends) from the company. Withdrawals from the cash pool account by the parent company, and payment into it by the subsidiary, should therefore not infringe the relevant rules – or else there is a risk of invalid distribution.

(3) Rules restricting a company's indebtedness

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

(4) Authorisation procedures

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

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

2. Liability risks

a) Liability of the shareholders

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

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

b) Liability of the directors or managers

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

(1) Criminal liability

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

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

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

(2) Civil liability

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

3. Legal structure and reduction of risks

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

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

b) Precautions to be taken in relation to written agreements

(1) Right to information

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

(2) Right to terminate the cash pooling arrangement

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

c) Guarantees to be granted

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

4. Tax issues

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

a) Interest deductibility and thin capitalisation rules

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

b) Transfer pricing rules

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

c) Withholding tax

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

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

Russia

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In Russia cash pooling is 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

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

2. Form of agreements for cash pooling

Russian banks provide their clients with "physical" 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 participate 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 inter-group loans. Such 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[1]. In practice, the master account is normally opened by the parent company.
— Each group company enters into an inter-group loan agreement with the parent company. Such inter-group loan agreement stipulates the possibility of loans being provided by the parent company to a subsidiary and vice versa [2].
— The inter-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 principle amount is repayable.
— The parent company enters into a master loan agreement with the bank. Under the terms of such master loan agreement the bank will, amongst 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.

[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 deal 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 substantial administrative burden.

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

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 inany 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"), the members of the board of directors (supervisory board), the general director (sole executive body) and the 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, then they may be liable for such loss (unless otherwise stipulated in Russian legislation).

Like the parent company (see above), the members of the management bodies, and other persons authorised to control the activities of the company, may also be liable for the losses of an insolvent company if such insolvency was caused by their actions (e.g. making a decision to use cash pooling services) or if it 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. The members of the 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 case 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, the banks too should be aware that their activities, including the provision of cash pooling services, are monitored by the Central Bank. If the cash pooling product or service breaches any provision of a federal law or any regulation of the Central Bank, the latter may fine the relevant bank up to 0.1% of the bank's charter capital, or restrict it from carrying out any banking activities for a term of up to six months. If the bank still does not conform to the relevant law, the Central Bank will be entitled to 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 the legal and tax stand point in order to develop a viable cash pooling structure for a particular company or group of companies as well as its / their structure and residence and business needs.

b) Objects of the company and corporate issues
The charter should include the objects of the company. The authority of the company's general director, management board and board of directors is limited by such objects, i.e. the board of directors may only pursue activities that fall within the scope of the company's objects. If the general director makes a decision to take any action that is beyond the scope of the company's objects, the general director may be held liable to the company and to third parties. The same applies to the other management bodies of the company.

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

According to the LLC Law and JSC Law, certain transactions of a company must be approved as major or interested-party transactions. Also, the company's charter may require that additional corporate approvals are provided. Failure to do so may serve as a ground for their invalidation.

Therefore, the charter of the company should 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 rightto 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.

5. Tax issues

The deductibility of interest for corporate income tax purposes (including that paid pursuant to a cash pooling arrangement) is allowed by the Russian tax authorities within a certain limit – the refinancing rate of the Central Bank multiplied by the coefficient 1.8 for loans in Roubles, and 0.8 for loans in a foreign currency[3].

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.

[3] These coefficients are set forth for 2012.

Serbia

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1. Legal framework

a) Introduction

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

Cash pooling is not a widely used financing method in Serbia. There are only a limited number of Serbian banks offering notional cash pooling arrangements.

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

b) Banking legislation

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

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

c) Company legislation

(1) Duty of care / conflict of interest

Shareholders of the company who (solely and / or acting in concert with third parties) hold a minimum 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 of the company owe a general duty of care and loyalty to the company and are subject to a corresponding liability for breach of these duties. 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 5 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 related persons) are deemed to be 'transactions involving a conflict of 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.

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

(2) Capital maintenance rules

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

Directors should therefore be careful to ensure that the company's contributions to the cash pool do not reduce the company's registered capital below the minimum required amount.

In addition, the Serbian Companies Act stipulates that the company cannot make distributions to the company shareholders if:

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

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

2. Liability risks

As a general rule, the company's directors and 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. It is considered that the company has been abused especially if the shareholder: 1) uses the company to achieve a goal which is prohibited; 2) uses or disposes 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 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 duties. Thus, any inter-group borrowing must not prejudice the interests of minority shareholders and creditors – if it does, the director risks criminal liability. To prevent this, the borrowing must be concluded on an at 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

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

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

Slovakia

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As noted in the introduction to this brochure, many of the risks outlined in this Slovakian submission do not apply to a purely notional cash pooling arrangement. In practice, however, a notional cash pooling arrangement will frequently involve the grant of crossguarantees 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:

(1) Director's 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 the director liable to the company for damages caused by his breach.

Generally speaking, the primary obligation of a duly diligent director of a Slovak company, acting in good faith, is to prevent the company from falling into insolvency. For a director, this obligation is particularly pertinent as a breach of his duty will not only make him liable to the company, but also 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 the insolvency of one participant may threaten the solvency of all the participants, exposing the directors to liability. The directors of cash pool participants will therefore need to take risk avoidance measures to protect the company. One such measure is to seek the ratification of the members of the company for the cash pooling arrangement. Under Slovakian company law, directors are not liable for damages caused to the company if they are carrying out the instructions of the members given by a decision of a general meeting (unless the instruction of the general meeting conflicts with legal regulation). Thus, once a cash pooling arrangement has been agreed it is advisable that the directors seek approval from the shareholders in a general meeting.

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

(2) Shareholders' liability

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

(3) Unlawful profit distribution or illegal capital repayment

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

b) Banking law

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

c) Foreign Exchange Act

Under the Slovakian Foreign Exchange Act (measure number 467 / 2010 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 1,000,000. If the cash pooling arrangement operates on a cross-border basis, the Slovak company may therefore have to make a report.

d) Criminal law

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

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

2. Risk management

Given that cash pooling arrangements in Slovakia are not subject to explicit legal regulation, it is 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 withdrawer become insolvent.

b) Right of information

Although it may be sensible for an illiquid participant to withdraw from the cash pool, its withdrawal and the return of its deposited funds may cause illiquidity problems for the other participants who are relying on those returned funds. In light of this, it 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 overreliant 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.

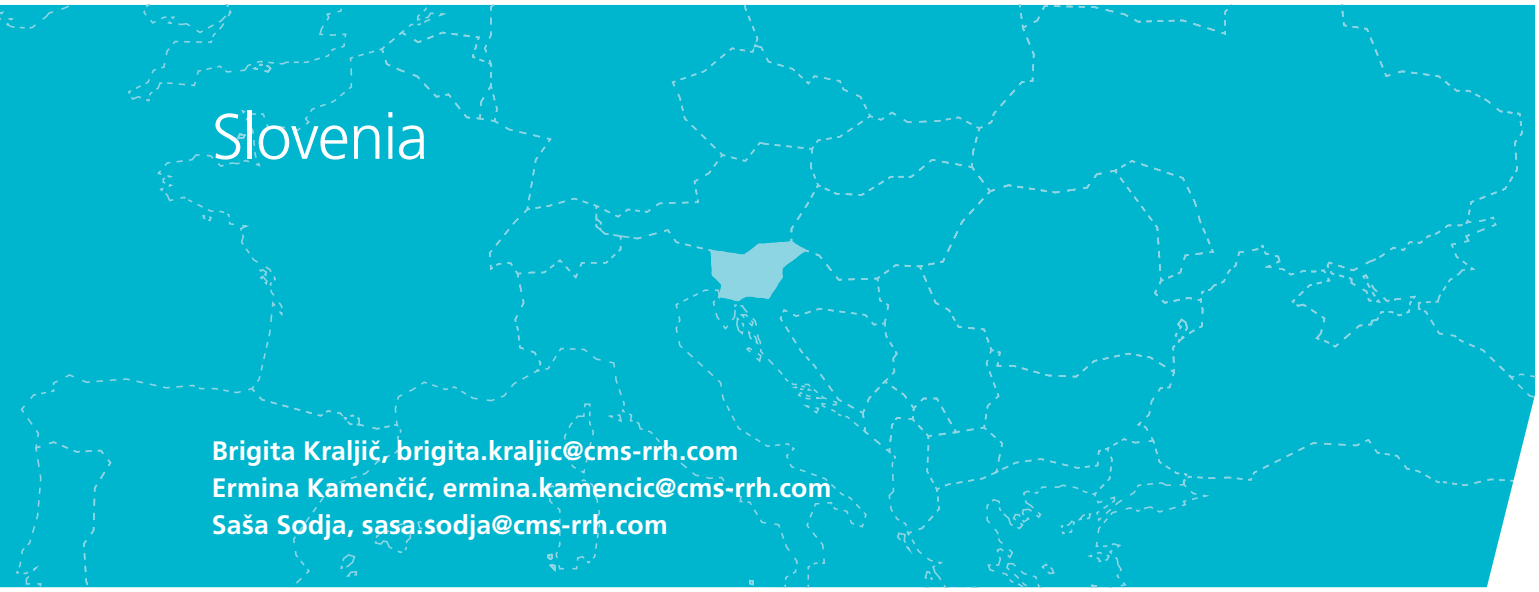
d) Joint and several liability and security
As a general rule, the individual facility agreement entered into between the bank and the participating companies will provide that the participating companies are jointly and severally liable for any negative balance on the master account, and will require 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 then the company's liability should be restricted, at the very least, to the lesser of: (i) the actual amount of funds withdrawn from the cash pool by the company at any one time; and, (ii) the amount by which its net assets exceed the minimum required share capital at law.

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

3. Tax issues

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

Slovenia



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1. Introduction

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

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

1. corporations and other legal entities with their registered office in the Republic of Slovenia (apart from their subsidiaries abroad) involved in commercial activity;
2. subsidiaries of foreign corporations that are involved in commercial activity and are registered in the Court Register in the Republic of Slovenia;
3. 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.

The residents must report in writing to the Bank of Slovenia their received and given loans and deposits with non-residents, including short-term financial obligations amongst which is 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 to the Bank of Slovenia 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.

2. Types

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

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

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

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

3. Liability risks

a) Director's liability
Every director of a company must act with the due diligence ofa 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 demonstrates that he fulfilled his duties fairly and conscientiously. Creditors of the company may also pursue a compensation claim by the company against the director, if the company is unable to repay its debts.

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

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

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

c) Capital maintenance rules
A company's equity may not be used to make payments, or give other benefits, to the company's shareholders

– unless there is a shareholder resolution providing for such payment or benefit (distribution of dividends or share capital decrease) – these are known as the 'capital maintenance rules'.

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

In a cash pooling arrangement, the share capital of subsidiaries must therefore not be repaid to the parent company. However, cash pooling may cause situations in which the parent benefits from its direct subsidiary's contribution into the cash pool. In case 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 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;
- mark-up for maturity of a loan; and
- mark-up for the debtor's credit rating based on the Standard & Poors' ranking or other similar credit rating agency.

Since 2008 the legislation enables the 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 be agreed between affiliated persons can be used for tax purposes only if its at arm's length nature can be proved.

The parties involved can prove the at arm's length nature of their contractual interest rates by conducting a transfer pricing study. Further, the tax authorities have issued a 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 at 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, please 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.

c) Thin capitalisation
The thin capitalisation rules may apply to interest paid in respect of the cash pooling agreement. Except in the case of loan recipients 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 17%) 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.

d) 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 in Slovenia, where the receiver has notified the payer of his / her tax number;
— on loans raised and issued by an authorised institution, in accordance with the law regulating insurance and financing of international business transactions, for which guarantees are issued in 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 Public Finance Act.

Furthermore, in line with the implemented Interest / Royalty 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:

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

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

— payer of the tax directly participates in at least 25% of the the beneficial owner's share capital or
— beneficial owner directly participates in at least 25% of the 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 the capital of both the beneficial owner and the payer;
— and in each instance, the minimum 25% participation lasts is at least 24 months; and

(3) the payer or the beneficial owner is:

— a company assuming a form to which the common system of taxation for interest payments and royalty payments made between associated companies of different EU Member States applies, and which are laid down by the financeminister;
— in accordance with the tax laws of an EU Member State, are considered to be residents of that state for tax purposes and, under the terms of a double taxation agreement concluded with a third state, are not considered to be residents outside the EU; and
— a company subject to either one of the taxes to which the common system of taxation for interest payments and royalty payments made between associated companies of different EU Member States applies, that are laid down by the finance minister, where a company exempt from tax is not deemed a taxpayer, or, subject to a tax which is identical or substantially similar, and is additionally introduced, or replaces, the existing tax.

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

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

Spain

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There are no specific laws governing cash pooling activities in Spain. Nor have there been any judicial decisions 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 in 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 for the entities participating in the cash pooling arrangement (other than the bank). This is true even of the treasury company, whose activities may be considered similar in some respects to those of a financial institution.

It should be noted that in the course of 2012 the Bank of Spain amended the information obligations regarding foreign transactions. Consequently, as of 31 December 2013 Spanish residents will no longer be obliged to notify the Bank of Spain when opening accounts abroad and making individual payments and receipts in relation to such accounts. From that date onwards, only simplified information obligations in respect of foreign transactions will apply.

2. Corporate issues

There are few corporate law limitations on cash pooling arrangements:

Cash pooling activities need not be listed as a specifc 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)[1]. 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.

[1] 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.

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. 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 where 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.

For this reason, it is usual to first obtain a shareholders' resolution approving the execution of the cash pooling agreements and related documents by the directors – thus at least limiting the directors' exposure to liability to the shareholders.

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 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 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.

3. Insolvency law

In general, the insolvency of a Spanish company involved in a cash pooling arrangement will not automatically result in the 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 as between such 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 is 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 is 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 the inter-company loans or other similar intra-group legal relationships have resulted in serious diffculties 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.

4. Tax law

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), then such payments will typically be regarded as interest. Where the centralising entity acts as an intermediary between the group and the bank, then such payments will usually be classified as management fees.

If one or more of the participants of the cash pooling arrangement is a / are Spanish resident(s), then 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 at arm's length terms.

In addition, as from January 1, 2012 the old thin capitalisation rules have been replaced by new interest deduction limitation rules. In general terms, following the new rules, interest accrued by a Spanish company is only deductible to the extent the net financial expenses (i.e. financial income less financial expenses) does not exceed 30% of a certain amount, which is defined by tax law and is essentially very similar to EBITDA. The excess amount may be deducted also within the same limits and under certain conditions. If in a given fiscal year, interest expenses do not reach 30% of EBITDA, the difference between the interest deducted and the said threshold can be carry forward, being added to the said threshold during the subsequent five years (i.e. 30% EBITDA cap may therefore be increased). Nevertheless, it may be worth pointing out that an amount of EUR 1m interest is considered deductible irrespective of the 30% limit.

Furthermore, stricter transfer pricing rules were introduced in Spain on 1 January 2007, 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 at 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 under an at 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 21% (formerly 19%) withholding tax would apply (at least during fiscal years 2012 and 2013), with the possible benefit of reduced rates under the provisions of an applicable double tax treaty. Tax form filing obligations also apply to the paying Spanish resident.


10,500
10,000
9,500

Switzerland

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1. Legal framework for cash pooling

There is no specific statutory framework and currently no relevant case law dealing with cash pooling in Switzerland. However, it is 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.

Theoretically, there are no restrictions on the grant 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 is paid at the market rate, but also that the protections that a commercial lender would usually require apply (in particular, the right of the lender to prematurely terminate the loan if the financial situation of the borrower deteriorates, and an appropriate risk diversification (i.e. no lump sum risks)).

If an intra-group loan (other than a mere downstream loan) is found not to be at arm's length, then 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.

In determining the relevant balance sheet values, in particular the freely distributable reserves, it is not sufficient to simply rely on the last annual financial statements. Reference must instead be made to the values at the time the relevant sums were transferred.

The above applies equally to any intra-group guarantee which is granted in connection with a notional cash pooling arrangement, respectively 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 at all times has sufficient liquidity 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

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.

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. Further, 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. In the case of intra-group guarantees, such 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 intra-group guarantee are lost, the company still has sufficient liquidity to pay its debts as they fall due.

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

4. Tax aspects

Theoretically, any payment 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. (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 reality however, it is often 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 (even where such payments are ultimately lost), 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 whole) to justify the related payments and loss risks.

Ukraine

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

1. Types of Arrangements 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:

(1) Refundable financial assistance ("RFA")

With RFA a company receives interest-free funds for a defined period of time under a financial assistance agreement. An RFA is therefore an interest-free loan, which enables one or more group companies to make a liquid sum of funds available to other group companies, in a similar manner to physical cash pooling.

It is recommended that an RFA with a parent company (including non-resident parent) is entered into pursuant to a written agreement with a term of up to 1 year. If this term is exceeded, the money lent will be treated as taxable income for corporate profit tax purposes (current CPT rate is 21%). Should the cash pool participants wish to extend their arrangement beyond 1 year, they will need to enter into new ones at the end of each 1 year-period.

If an RFA is entered into with other non-resident group members (except for a non-resident parent) as lenders, the amounts which are not returned by the end of the respective tax period (quarter) are treated as taxable income of the resident borrower to the full extent.

If an RFA is entered into between resident group members, a "fiscal" interest (equal to the discount rate of the National Bank of Ukraine, currently 7.5%) is accrued on all amounts which are not returned by the end of the respective tax period (quarter).

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.

(2) An interest-bearing loan

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

However, it is important to note that if one of the contributing participants is a non-resident, the loan agreement 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.

(3) Alternatives for branch offices

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

b) Virtual cash pooling

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

2. Reducing risk

Given that there is no specific legal framework surrounding cash pooling in Ukraine, there is some legal uncertainty. It will therefore be hard to mitigate or eliminate all risks. This is especially true considering the above arrangements have not been tested in Ukraine, in a cash pooling context, for some time. Nevertheless, 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 threatening to swallow the pooled cash.

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1. Corporate benefit

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 and / 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 and / 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 the 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 Financial Services 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; and
— the bank must monitor and control the risks associated with the termination of the arrangement.

The Financial Services Authority Handbook also acknowledges that cross-guarantees between group companies help to create mutuality of debts between those companies, allowing the bank to report transactions on a net 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, then 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, intercompany 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 intercompany 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 intercompany 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, then 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 repaid 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 benefit 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, then 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 recharacterised 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 CTA, 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, income 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 chargeable under Case III of Schedule D of ICTA, 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 recharacterised as a dividend there is also no requirement to withhold tax in respect of it.

(d) Cap on interest deductibility
With effect for accounting periods beginning on or after 1 January 2010, UK members of a multinational group will see their tax deductions for interest payments restricted by reference to the 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 will be reversed, such that they will be 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 will 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 transactions.

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